



**PART 2A OF FORM ADV:  
FIRM BROCHURE**

**KNIGHTHEAD CAPITAL MANAGEMENT, LLC**

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**This brochure provides information about the qualifications and business practices of Knighthood Capital Management, LLC. If you have any questions about the contents of this brochure, please contact us at (212) 356-2900 and/or info@knighthood.com. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the "SEC") or by any state securities authority.**

**Additional information about Knighthood Capital Management, LLC also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

**Being a "registered investment adviser" or describing oneself as being "registered" does not imply a certain level of skill or training.**

**This brochure shall not constitute an offer to sell or the solicitation of any offer to buy any security.**

## **ITEM 2. MATERIAL CHANGES**

Knighthead Capital Management, LLC (“**Knighthead**”) is updating its Firm Brochure as of March 27, 2019, as part of its annual amendment filing. There have been no material changes made to this brochure since the last update of this brochure on March 22, 2018.

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#### ITEM 4. ADVISORY BUSINESS

Knighthead Capital Management, LLC (“**Knighthead**”) is a Delaware limited liability company that was founded in 2008. Ara Cohen and Thomas Wagner (collectively, the “**Principals**”) are the principal owners of Knighthead and the portfolio managers primarily responsible for all investment decisions. Knighthead is based in New York and also has offices in Connecticut and Florida. Knighthead or its Principals, either directly or indirectly, control (i) Knighthead GP, LLC, a Delaware limited liability company (“**Knighthead GP**”), which serves as the general partner of the Domestic Fund and the Master Fund, as defined below; (ii) Knighthead Realty Capital Management, LLC, a Delaware limited liability company (“**Knighthead Realty**”), which serves as the investment manager for Knighthead Special Situations Real Estate Fund, L.P., a Delaware limited partnership, (the “**Real Estate Fund**”) and Knighthead Special Situations Real Estate Fund II, L.P., a Delaware limited partnership, (the “**Real Estate Fund II**” and together with the Real Estate Fund, the “**Real Estate Funds**”); (iii) Knighthead SSREF GP, LLC, a Delaware limited liability company (“**SSREF GP**”), which serves as the general partner for the Real Estate Fund; (iv) Knighthead GP-II, LLC, a Delaware limited liability company (“**Knighthead GP-II**”), which serves as the general partner for SSREF GP and SSREF GP-II, as defined below; (v) Knighthead SSRE REIT, Inc., a Delaware corporation (“**SSRE REIT**”), a real estate investment trust; (vi) Knighthead SSREF GP-II, LLC, a Delaware limited liability company (“**SSREF GP-II**”), which serves as the general partner for the Real Estate Fund II; (vii) Knighthead SSRE REIT II, Inc., a Delaware corporation (“**SSRE REIT II**”), a real estate investment trust; (viii) Knighthead Capital Management SMA, LLC, a Delaware limited liability company (“**Knighthead SMA**”), the investment advisor to BIOV1 Segregated Portfolio, defined below; (ix) Knighthead (NY) GP, LLC, a Delaware limited liability company, (“**Knighthead NY GP**”), which serves as the general partner of Knighthead (NY) Fund, L.P., a Delaware limited partnership (“**Knighthead NY Fund**”); (x) Knighthead Insurance Capital Management, LP, a Delaware limited partnership (“**Knighthead Insurance**”), the investment advisor to Knighthead Annuity and Knighthead Holdings, each as defined below; (xi) Knighthead IM GP, LLC, a Delaware limited liability company, (“**Knighthead IM GP**”), an affiliate of Knighthead Insurance; and (xii) Knighthead Insurance GP, LLC a Delaware limited liability company, (“**Knighthead Insurance GP**”) (Knighthead, Knighthead Realty, Knighthead SMA and Knighthead Insurance, collectively, the “**Adviser**”).

Knighthead provides investment advisory services to: (i) Knighthead Master Fund, L.P., a Cayman Islands exempted limited partnership (the “**Master Fund**”), (ii) Knighthead Domestic Fund, L.P. a Delaware limited partnership (the “**Domestic Fund**”), which is a feeder fund in the Master Fund, and (iii) Knighthead Offshore Fund, Ltd., a Cayman Islands exempted company (the “**Offshore Fund**”, and collectively with the Master Fund and the Domestic Fund, the “**Knighthead Master Feeder Funds**”), which is also a feeder fund for the Master Fund. In addition, Knighthead currently advises the Knighthead NY Fund, Sentinel Security Life Insurance Company, a company organized in Utah (“**Sentinel**”), Equitable Life & Casualty Insurance Company, a company organized in Utah (“**Equitable**”) and Trinity Life Insurance Company, a company organized in Oklahoma (“**Trinity**” and, collectively with Sentinel and Equitable, the “**Managed Account Clients**”); is the sub-advisor to Knighthead Annuity & Life Assurance Company, a life assurance company domiciled in the Cayman Islands (“**Knighthead Annuity**”) and Knighthead Holdings Ltd, a Cayman Islands exempted company (“**Knighthead Holdings**”) (Knighthead NY Fund, the Managed Account Clients, Knighthead Annuity,

Knighthead Holdings and the Knighthead Master Feeder Funds, collectively, the “**Funds**” and each individually, a “**Fund**”). The Adviser has sole responsibility for all investment decisions on behalf of the Funds and the Real Estate Funds (each a “**Knighthead Fund**” and collectively, the “**Knighthead Funds**”).

In addition to the Funds, Knighthead provides advisory services to third-party managed funds: (i) BSOF Master Fund, L.P., BSOF Parallel Master Fund, L.P., BSOF Parallel Moat Fund L.P., and BSOF Master Fund II L.P., each a Cayman Islands exempted limited partnership (collectively, the “**BSOF Funds**”), (ii) CPPIB MAP CAYMAN SPC, acting on behalf of and for the account of Segregated Portfolio I, an exempted company registered as a segregated portfolio company incorporated under the laws of the Cayman Islands (“**CPPIB**”), and Knighthead SMA provides advisory services to (iii) J.P. Morgan Omni SPC, Ltd., a Cayman Islands segregated portfolio company acting on behalf of and for the account of BIOV1 Segregated Portfolio (the “**BIOV1 Segregated Portfolio**” and together with the BSOF Funds and CPPIB, the “**Subadvised Funds**”), whereby the Adviser provides the Subadvised Funds with the opportunity to co-invest in certain Knighthead Master Feeder Fund investments in which there is excess capacity or where an investment idea is not suitable for the Knighthead Master Feeder Funds but may be suitable for the Subadvised Funds. The Subadvised Funds must approve a co-investment opportunity before the Adviser may make such an investment on behalf of the Subadvised Funds (each approved co-investment opportunity, an “**Approved Investment**”). While the Adviser has full discretionary investment and trading authority over Approved Investments made on behalf of the Subadvised Funds, it does not have discretion of the Subadvised Funds generally.

The primary investment objective of the Funds is to generate attractive risk adjusted returns while emphasizing the preservation of capital. There can be no assurance that this investment objective will be achieved and investment results may vary substantially. Knighthead primarily invests its Funds’ assets in the debt securities or loans of leveraged or financially distressed companies and in companies with undervalued equity securities. Many of these distressed companies will undergo debt restructurings or reorganizations under federal bankruptcy law, while others may restructure outside of bankruptcy. The Funds may also invest in equity and other securities that Knighthead believes are trading at substantial discounts to their underlying value, particularly if there are catalysts which may eliminate these discounts.

The Real Estate Funds’ primary investment objective is to originate short-term U.S. real estate secured loans and to make or acquire other loans or other real estate related investments in connection with real estate development or other special situations.

The Adviser tailors its investment advice in accordance with the investment objective and strategy of the applicable Knighthead Fund. The Adviser does not tailor its advisory services to the needs of any particular investor in the Knighthead Funds. Investment advice is not tailored for the Subadvised Funds, as Knighthead presents the Subadvised Funds only with co-investment opportunities based on its investment objectives.

The Adviser does not currently provide investment advisory services to clients apart from the Knighthead Funds and the Subadvised Funds (together, the “**Clients**” and each individually, a “**Client**”), although it and/or its affiliates may do so in the future.

The Adviser manages the assets of the Knighthood Funds on a discretionary basis. Knighthood does not manage the assets of the Subadvised Funds on a discretionary basis, although it does have investment and trading control over the Approved Investments. As of December 31, 2018, the Adviser's discretionary regulatory assets under management were approximately \$3.877 billion and the Adviser's non-discretionary regulatory assets under management were approximately \$221 million. For a further discussion of these and related items, see **Item 7** (Types of Clients), **Item 8** (Methods of Analysis, Investment Strategies and Risk of Loss) and **Item 10** (Other Financial Industry Activities and Affiliations).

## ITEM 5. FEES AND COMPENSATION

### Management Fee and Performance Allocation

Management fees may vary with each Client and are explained more fully in each Client's confidential offering memorandum or investment management agreement. It is critical that the Clients and prospective investors refer to their respective governing documents for a complete understanding of how Knighthead is compensated for its advisory services.

#### Knighthead Master Feeder Funds

Knighthead receives from the Knighthead Master Feeder Funds quarterly investment management fees (the "**Management Fee**") at an annual rate generally up to 1.75%. Knighthead may waive or reduce the Management Fee with respect to certain investors. The Management Fee for capital contributions made, or shares purchased, during a calendar quarter will be charged pro rata for the initial quarter of purchase. For purposes of determining the Management Fee, Designated Investments (as defined in **Item 8** below) will be valued at cost, or market value on the date first designated as a Designated Investment if such date is after the date such investment was acquired, unless Knighthead, in its sole discretion, determines a different valuation is more appropriate. Knighthead may allocate a portion of the Management Fee to a third party.

Knighthead's affiliate, Knighthead GP, is entitled to receive from the Master Fund an annual performance-based profit allocation (the "**Performance Allocation**") in an amount generally up to 20% of net profits (including net unrealized gains on investments other than those attributable to Designated Investments and including net profits or losses attributable to the sale or deemed sale of Designated Investments), if any, allocable to the pro rata share of such Knighthead Master Feeder Fund's interest in the Master Fund, subject to a loss carryforward. The Performance Allocation generally will be allocated at the end of each fiscal year. In the event of a withdrawal or redemption occurring prior to the end of any fiscal year, the Performance Allocation will be computed and charged as though such withdrawal or redemption date were the last day of the fiscal year. Knighthead GP may allocate a portion of the Performance Allocation to a third party.

The Management Fee and the Performance Allocation may be waived, reduced or rebated at the discretion of Knighthead GP.

#### Knighthead NY Fund

Knighthead receives a quarterly management fee from the Knighthead NY Fund, payable in advance, in accordance with the terms of their relevant agreement. An affiliate of Knighthead also receives a Performance Allocation as set forth in the relevant agreement between Knighthead and the Knighthead NY Fund.

#### Knighthead Annuity and Knighthead Holdings

Knighthead Insurance receives a quarterly management fee from Knighthead Annuity and Knighthead Holdings, valued in advance and payable quarterly in arrears, in accordance with

the terms of their relevant agreement. An affiliate of Knighthead also receives a Performance Allocation as set forth in that certain joint venture agreement by and among Knighthead Holdings, Knighthead Annuity, Knighthead Insurance GP and Knighthead Insurance (the “**JV Agreement**”).

#### Managed Account Clients

Knighthead receives a monthly management fee from the Managed Account Clients payable quarterly in arrears in accordance with the terms of their relevant investment management agreement. Knighthead and Knighthead Realty may receive performance fees and management fees from the Funds in which is the Managed Account Clients are invested.

#### Subadvised Funds

##### BSOF Funds

Knighthead has been admitted as a special limited partner of each of the BSOF Funds, entitling it to receive a carried interest from such BSOF Fund as soon as reasonably practicable following the complete disposition of an Approved Investment. The carried interest shall be equal to the applicable percentage (set forth below) of the amount by which (i) the total cash proceeds derived by the BSOF Fund from each Approved Investment exceeds (ii) all costs and expenses incurred by the BSOF Fund in connection with the acquisition, ownership and disposition of the entire Approved Investment, calculated on an aggregate basis across all Approved Investments for such BSOF Fund and subject to a high water mark. The applicable percentage is set forth in the respective documentation with the BSOF Funds.

##### BIOV1 Segregated Portfolio

Knighthead SMA receives an annual performance fee, annually in arrears, from the BIOV1 Segregated Portfolio, subject to a loss carryforward, at the end of each fiscal year. The annual performance fee is set forth in the respective documentation with the BIOV1 Segregated Portfolio.

##### CPPIB

Knighthead shall receive a performance fee from the CPPIB Segregated Portfolio with respect to each Approved Investment as set forth in the investment management agreement between Knighthead and CPPIB.

#### Real Estate Fund

Knighthead Realty receives a management fee at an annual rate generally equal to 1.0% of the value of each investor’s investment, valued and payable in advance as of the beginning of each quarter (0.25% per quarter). Knighthead Realty will be entitled to retain processing and similar fees paid by borrowers as part of the loan application process and will also be entitled to reimbursement of certain of its expenses, but will not receive any other fees for its services other than the management fee described above. All distributable cash will initially be allocated to the limited partners of the Real Estate Fund and SSREF GP pro rata in proportion to their respective

percentage interests in the Real Estate Fund. Amounts allocated to the limited partners will be distributed to the limited partners and SSREF GP in the following amounts and order of priority:

(a) First, one hundred percent (100%) to such limited partner until such limited partner has received under this clause (a) cumulative distributions equal to a six percent (6%) per annum, annually compounded return on such partner's net capital contributions outstanding from time to time;

(b) Second, one hundred percent (100%) to such limited partner until such limited partner has received under this clause (b) cumulative distributions equal to such partner's cumulative net capital contributions;

(c) Third, (A) eighty percent (80%) to SSREF GP and (B) twenty percent (20%) to the limited partner until such time as SSREF GP has received under clause (A) of this clause (c) twenty percent (20%) of the amounts distributed under clause (a) above and this clause (c) with respect to such limited partner; and

(d) Thereafter, (A) twenty percent (20%) to SSREF GP and (B) eighty percent (80%) to such limited partner.

#### Real Estate Fund II

For Real Estate Fund II, Knighthead Realty receives the following management fees: (i) one and one half percent (1.5%) per annum of such investor's *pro rata* share of its invested capital during the commitment period to invest the capital; and (ii) after the investment commitment period, one percent (1%) per annum of such investor's *pro rata* share of its invested capital. Management fees are paid in advance and shall be based upon estimated amounts of the invested capital for the applicable quarter with any difference adjusted at the end of the quarter.

Knighthead Realty will be entitled to retain processing and similar fees paid by borrowers as part of the loan application process and will also be entitled to reimbursement of certain of its expenses, but will not receive any other fees for its services other than the management fee described above. All distributable cash will initially be allocated to the limited partners of the Real Estate Fund and SSREF GP pro rata in proportion to their respective percentage interests in the Real Estate Fund. Amounts allocated to the limited partners will be distributed to the limited partners and SSREF GP in the following amounts and order of priority:

(a) First, one hundred percent (100%) to such limited partner until such limited partner has received under this clause (a) cumulative distributions equal to such limited partner's cumulative net capital contributions;

(b) Second, one hundred percent (100%) to such limited partner until such limited partner has received under this clause (b) cumulative distributions equal to a six percent (6%) per annum, annually compounded return on such partner's net capital contributions outstanding from time to time;

(c) Third, (A) eighty percent (80%) to SSREF GP-II and (B) twenty percent (20%) to such limited partner until such time as SSREF GP-II has received from

distributions under clause (A) of this clause (c), equal to twenty percent (20%) of the aggregate amounts distributed under this section with respect to such limited partner (other than amounts distributed to such limited partner in respect of its cumulative net capital contributions under clause (a)); and

(d) Thereafter, (A) twenty percent (20%) to SSREF GP-II and (B) eighty percent (80%) to such limited partner.

## **Expenses**

### Knighthead Master Feeder Funds, Knighthead NY Fund, Knighthead Annuity and the Real Estate Funds (the “KH Funds”)

As more fully described in each KH Fund’s respective offering document or investment management agreement, each KH Fund will generally bear expenses incidental to its operations and business. These expenses may include, but are not limited to, legal, accounting, auditing, valuation, cybersecurity, compliance and regulatory expenses (including, without limitation, third-party expenses incurred by the KH Funds and the Adviser), fund-related insurance expenses and other professional expenses, including any fees to an administrator, research expenses (including research-related travel), trading related technology, investment expenses such as commissions, interest on margin accounts and other indebtedness, custodial fees, bank service fees, direct fees and expenses, such as legal fees and due diligence expenses, related to the analysis, purchase or sale of investments (including Designated Investments) whether or not the investment is consummated, guarantees (including any interest thereon) and temporary investments, including the investigation, evaluation, acquisition, holding, financing, leasing, hedging and disposition thereof, including, without limitation, attorney fees and expenses and transportation, meal and lodging expenses of the personnel of the general partner and the Adviser, which may include, in certain circumstances, business or first class airfare and other reasonable expenses related to the purchase, sale or transmittal of KH Fund assets as determined by the Fund’s respective general partner or investment manager in their sole discretion. Any expenses directly attributable to a particular Designated Investment will be charged solely to investors participating in such Designated Investment. The Knighthead Master Feeder Funds also indirectly bear the administrative and other expenses of the Master Fund pro rata based on its interest in the Master Fund. The Real Estate Funds may bear (i) sales and brokerage commissions and fees, commitment fees and costs and expenses incurred in the origination, purchase, syndication and sale of investments, including fees of mortgage brokers and other intermediaries and the costs of marketing and advertising the fund’s or any affiliate’s lending services and attending trade shows and other similar events; (ii) normal and customary servicing fees payable to third parties that may act as a service provider for investments; (iii) expenses of the Real Estate Funds’ Advisory Board and Investment Committee; (iv) costs and expenses that are extraordinary expenses; (v) taxes and other governmental charges, fees and duties payable by the fund; (vi) claims, damages, liabilities, costs (including legal fees) and expenses incurred by covered persons under certain indemnification provisions set forth in the relevant partnership agreement; (vii) costs of preparing and distributing reports to the partners (other than internally prepared reports) and costs of any meeting of the partners incurred by the fund or the general partner; (viii) costs and

expenses associated with litigation, arbitration and similar proceedings involving the fund; (ix) and costs of winding up and liquidating the fund.

The organizational expenses of the Knighthood Master Feeder Funds, Knighthood Annuity and the Real Estate Funds (including expenses of the initial offer and sale of interests) were or will be paid by the respective Fund.

#### Managed Account Clients

As more fully described in each Managed Account Client's investment management agreement, all reasonable and appropriate expenses incurred in connection with maintenance of the accounts and assets in the accounts' portfolios are paid from the subject account.

#### Subadvised Funds

All trading costs and expenses associated with an Approved Investment (including legal expenses incurred in connection with the negotiation, purchase, settlement and transfer of an Approved Investment as well as legal expenses associated with the specific legal analysis and research of the structuring or restructuring of an Approved Investment) will be borne by the Subadvised Funds (subject to allocation among all co-investment accounts on a pro rata basis in accordance with the extent and timing of their participation).

More detailed information regarding the expenses to which each Client is subject is set out in each fund's offering and/or disclosure document.

For a further discussion of these and related items, see **Item 12** (Brokerage Practices).

## **ITEM 6. PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT**

The Adviser generally charges performance based fees or allocations. Please see **Item 5** (Fees and Compensation) above. The Adviser may provide investment advisory services to additional clients in the future that may have similar or different performance-based fees and/or allocations than the performance-based fees and/or allocations of its current Clients (including other privately-offered pooled alternative investment funds, some of which may have an investment strategy substantially similar to the Funds).

The Performance Allocation may create an incentive for the Adviser to make investments that are riskier or more speculative than would be the case in the absence of the Performance Allocation.

The Adviser is required to act in a manner that it considers fair, reasonable and equitable in allocating investment opportunities to the Clients, but the Adviser and its affiliates are not otherwise subject to any specific obligations or requirements concerning the allocation of time, effort or investments opportunities, or any restrictions on the nature or timing of investments for the Clients.

## **ITEM 7. TYPES OF CLIENTS**

Knighthead provides investment advisory services to the Knighthead Master Feeder Funds, Knighthead NY Fund, the Managed Account Clients, the BSOF Funds and CPPIB and is the sub-advisor to Knighthead Annuity and Knighthead Holdings. Knighthead SMA provides investment advisory services to BIOV1 Segregated Portfolio. Knighthead Realty provides investment advisory services to the Real Estate Funds, SSRE REIT and SSRE REIT II. Knighthead Insurance provides investment advisory services to Knighthead Annuity and Knighthead Holdings. The Adviser may in the future provide investment advisory services to additional clients including, but not limited to, other pooled investment vehicles, corporations, trusts, institutions, high net worth individuals, investment companies, pension plans, sovereign wealth funds, family offices, foundations and endowments.

For a further discussion of these and related items, see **Item 4** (Advisory Business) and **Item 10** (Other Financial Industry Activities and Affiliations).

## **ITEM 8. METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS**

### **Methods of Analysis**

Knighthead uses a variety of investment strategies and has broad and flexible investment authority discretion. In general Knighthead utilizes a “bottoms up” approach to fundamental investing. Knighthead employs a rigorous research process to investment opportunities that may include, but is not limited to, fundamental credit analysis, portfolio analytics, the review of historical financial data, meeting with company management, industry research and analysis of documents (including, but not limited to, indentures, credit agreements, inter-creditor agreements, court filings), as well as, using outside advisors (legal counsel or financial advisors) to assist in the review of the certain issues in connection therewith. More detailed information with respect to the following investment strategies is included in each fund’s offering and/or disclosure documents.

### **Investment Strategies**

#### **Distressed and Stressed Investments**

Knighthead analyzes the securities of companies that are facing business or financial problems. These problems may include industry issues (pricing, lack of demand, technological change, etc.), management issues and legal or regulatory issues. Knighthead believes the markets for these types of securities are frequently inefficient because existing holders are often unprepared or ill-equipped to evaluate the impact that business problems will have on the value of their securities. Consequently, there is a natural redistribution of these securities to holders whose investment horizon and value orientation allow them to buy securities that are often deeply out of favor.

Knighthead analyzes companies along several dimensions, including its competitive position, industry prospects, liquidity, capital needs, financial resources, legal issues, asset value, liquidation value, management resources and projected cash flows. Knighthead then combines this analysis with an analysis of potential restructuring plans and the estimated timing of any reorganization. The form of investment depends upon the capital structure of the company, the relative prices of its debt and equity securities and the terms of those securities (including collateral, covenants and claim amounts).

Many different types of distressed assets exist in which the Funds may invest, including senior bank debt, senior notes and subordinated notes. Bank debt is a privately traded instrument that is often illiquid. However, bank debt is frequently secured by collateral and is generally the most senior level of the capital structure. Senior and subordinated notes may be publicly traded or they may be privately placed. Public notes are usually not listed on an exchange but they are freely traded through institutional brokers. Other distressed investment instruments include Trade Claims (as defined below) or other claims, liquidating trusts and litigation trusts. The focus of the Funds’ distressed investments will be on companies domiciled in the U.S. and in OECD countries. The Funds may invest in companies domiciled in other countries, including

emerging markets. However, these investments generally will be limited to a small portion of the portfolio.

While Knighthead expects most of the Funds' investments to be passive investments, the Funds may participate actively in the reorganization process when Knighthead determines that this is desirable. A Fund's participation may involve working with other creditors and could include membership on ad hoc or official creditors' committees when Knighthead believes that the advantages outweigh the trading, confidentiality and other restrictions that such membership often entails.

### **High Yield Investments**

The Funds may invest in high yield bank debt and bonds as a supplement to their focus on distressed securities. The high yield market consists of secured and unsecured debt of companies that are rated below investment grade. The market is quite large and has grown rapidly due to the increase in leveraged buyout activity. Investments in the high yield market typically have less risk than investments in distressed securities and consequently have lower expected returns. The Funds seek to invest in the high yield market for both income and capital appreciation. In the case of bank loans, certain senior or secured bonds, or bonds that are expected to be refinanced within three years, the Funds' main focus is to benefit from the income on the loans or bonds. In the case of longer term bonds, the Funds' goals are to earn income and seek capital gains through a reduction or narrowing of the credit spreads due to an improvement in the credit quality of the company over time.

High yield bonds and loans are usually fairly liquid, but the market does have periods of illiquidity, some which are due to events in the credit markets (oversupply of new issues, large defaults, etc.) and some of which are due to dislocations in other markets (U.S. equity market, U.S. Government bond market, hedge fund or mutual fund losses or withdrawals, etc.). The Funds seek to invest in the high yield market when these periods of illiquidity exist, because prices are usually attractive relative to credit risk during such periods.

The Funds also utilize the high yield market to short bonds with deteriorating credit fundamentals and to enter into capital structure arbitrage trades where the Funds will purchase bonds at one level of the capital structure and hedge their investment by shorting other bonds at a different layer of the capital structure. The Funds may also utilize credit default swaps to effectuate short positions.

### **Other Investments**

Knighthead, on behalf of the Funds will purchase equity and other securities that utilize complementary investment skills to their debt strategy. Knighthead also employs a value-oriented strategy focused on companies whose securities have declined substantially due to industry or company specific issues. Another strategy Knighthead employs is to focus on investments in undervalued securities where a catalyst may bring about a revaluation of its securities. The types of catalysts that drive pricing include restructurings, reorganizations, spin-

offs, management appointments, capital market transactions, lawsuits, regulatory decisions, industry consolidation and asset divestitures.

A Fund's portfolio may change considerably, depending on the types of opportunities that are available. At any given time, there may be a concentration of companies in one industry that is undergoing financial distress, or there may be times when economic conditions are so robust that there are few good opportunities in distressed securities. Knighthead will evaluate the potential returns available in the investment strategies discussed above (and other appropriate strategies as determined by Knighthead) and adjust the portfolio with the objective of maximizing its risk-adjusted return. In particular, in order to maintain flexibility and to capitalize on investment opportunities as they arise, a Fund will not be required to invest any particular percentage of its portfolio in any type of strategy, investment, industry or region, and the amount of a Fund's portfolio which is invested in any type of strategy or investment, which is long or short or which is weighted in different industries or regions, can change at any time based on the availability of attractive market opportunities.

Knighthead will seek to minimize the risk of capital loss for each Fund. Knighthead will continually evaluate the risk of potential loss on individual positions and employ several means of risk management. First, the Funds' strategy of investing in securities that have already declined substantially should limit risk since most of these securities will be trading at valuation discounts to the overall market. Second, Funds may diversify their investments among different markets, asset classes and industries. Third, Funds may hedge some of their investments by selling short securities that are directly or indirectly related to their investments. Fourth, Funds may at times enter into market hedges to protect against dramatic and sustained declines in equity valuations. Although Funds will likely employ the hedges mentioned above, they generally will have a net long portfolio.

The Knighthead Master Feeder Funds may invest up to 15% of the portion of their net assets attributable to investors who participate in Designated Investments (measured at the time of investment) in securities for which there is no ready market and/or which Knighthead, in its sole discretion, determines should be treated as a "**Designated Investment**". These investments may include securities which are subject to legal or contractual restrictions on sale, are not traded on any exchange or in the over-the-counter market, or which Knighthead determines should be held until the resolution of a special event or circumstance.

The Knighthead Master Feeder Funds may utilize leverage at such times and in such amounts as Knighthead deems prudent. It is not anticipated that the Knighthead Master Feeder Funds will utilize margin borrowings, repos or similar leverage in excess of two and one half times their net assets for sustained periods; however, the Knighthead Master Feeder Funds may also utilize instruments such as swaps or options, which contain inherent leverage.

A Fund's investments may at any time include long or short positions in U.S. or non-U.S., publicly traded or privately issued or negotiated common stocks, preferred stocks, stock warrants and rights, sovereign debt, corporate debt, bonds, notes or other debentures or debt participations, claims, convertible securities, swaps, options (purchased or written), futures contracts, commodities, derivatives (including, but not limited to, credit default swaps and

interest rate swaps), foreign exchange transactions, partnership interests and other securities or financial instruments including those of investment companies.

## **The Real Estate Funds**

The Real Estate Funds' primary investment objectives are to originate short-term U.S. real estate secured loans. The Real Estate Funds intend to target loans with maturities ranging from 12 to 36 months, fixed and floating interest rates between 6% and 12% per annum and transaction fees of 1% to 3%. Targeted investments may include loans up to \$50 million in size, primarily senior secured first mortgage loans, with loan-to-value ratios typically less than 75%. The Real Estate Funds may lend against all different types of real estate collateral, including office, industrial, multi-family, hospitality, bulk condo, residential and retail commercial properties. The loans will primarily be secured by a first/senior lien security interest in real estate collateral. However, the Real Estate Funds may also make loans secured by second/ junior liens, leasehold mortgages, tax liens, defaulted mortgages, shares in a co-operative or a pledge of ownership interests and/or preferred equity in a real estate property.

The Real Estate Funds anticipate that most of its loans will be made to borrowers faced with time constraints, recapitalization needs, liquidity needs, development or redevelopment, distress or other event-driven situations.

The Real Estate Funds' investments will largely consist of first-lien senior secured mortgages with loan-to-value typically less than 75%. Primary collateral for loans in the Real Estate Funds will be the value of the underlying real estate.

All investments in the Real Estate Funds may generate interest income and other income including, but not limited to, origination fees, late fees, default interest, exit fees, extension or modification fees, or capital gains, income or profit participation. In some cases the properties securing the Loans will not be producing current cash flow during the term of the Loan. In those cases the fund will structure interest escrow accounts or Loans that pay interest as payment-in-kind or on an accrual basis prior to maturity.

**THERE CAN BE NO ASSURANCE THAT THE CLIENTS WILL ACHIEVE THEIR INVESTMENT OBJECTIVE.**

### **Risk of Loss**

#### **General Risk of Loss**

**Leverage.** While the use of margin and borrowed funds can substantially improve the return on invested capital, such use may also increase the adverse impact to which the investment portfolio of a Fund may be subject. If a Fund uses leverage with respect to a position, any losses would be more pronounced than if leverage were not used, and a relatively small price movement in a security or other financial instrument may result in immediate and substantial losses to the Fund, including, without limitation, losses in excess of the amount invested. Borrowings will usually be from securities brokers and dealers and will typically be secured by the Fund's securities and other assets. Under certain circumstances, such a broker-dealer may

demand an increase in the collateral that secures the Fund's obligations and if the Fund were unable to provide additional collateral, the broker-dealer could liquidate assets held in the account to satisfy the Fund's obligations to the broker-dealer. Liquidation in that manner could have extremely adverse consequences. In addition, the amount of the Fund's borrowings and the interest rates on those borrowings, which will fluctuate, will have a significant effect on the Fund's profitability. In addition, the lender or counterparty, as the case may be, may have a security interest in, or otherwise acquire, all or a portion of the Fund's assets. In the event that the Fund defaults under any such arrangement, such lender or counterparty may have the right to become or remain the owner of all or that portion of the Fund's assets secured pursuant to such arrangement. If such arrangement is terminated, the Fund's ability to meet its investment objective may be adversely impaired. The Fund will bear all of the costs and expenses incurred in connection therewith, including, without limitation, any interest expense charged on funds borrowed or otherwise accessed.

No restrictions exist on the use of leverage by the Funds other than restrictions which may be imposed by lenders from time to time. However, for the Knighthood Master Feeder Fund, Knighthood does not anticipate utilizing margin borrowings, repos or similar leverage at more than two and one half times the value of a Fund's portfolio (although it may also utilize instruments such as swaps or options which contain inherent leverage).

**Short Sales.** A Fund's investment program may include short selling. Short sales may, in certain circumstances, substantially increase the impact of adverse price movements on a Fund's portfolio. A short sale of a security involves the risk of a theoretically unlimited increase in the market price of the security which could result in an inability to cover the short position or the theoretically unlimited loss. There can be no assurance that securities necessary to cover a short position will be available for purchase.

**Options.** Funds may utilize options in furtherance of their investment strategies. Option positions may include both long positions, where a Fund is the holder of put or call options, as well as short positions, where the Fund is the seller (writer) of an option. Although option techniques can increase investment return, they can also involve a higher level of risk compared with their underlying securities. For example, the expiration of unexercised long options effectively results in loss of the entire cost, or premium paid for the option. Conversely, the writing of an uncovered put or call option can involve, similar to short selling, a theoretically unlimited risk of an increase in the Fund's cost of selling or purchasing the underlying securities, commodities or other financial instruments in the event of exercise of the option.

**Non-U.S. Securities.** Investing in securities of non-U.S. governments and companies domiciled or operating outside of the United States involves certain considerations comprising both risks and opportunities not typically associated with investing in securities of the U.S. Government or U.S. companies. These considerations include changes in exchange rates and exchange control regulations, political and social instability, expropriation, imposition of foreign taxes, less liquid markets and less available information than are generally the case in the United States, higher transaction costs, less government supervision of exchanges, brokers and issuers, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility.

**High Risk Investments.** The Funds invest in debt and equity securities, accounts and notes payable, loans, private claims and other financial instruments and obligations of troubled companies which may result in significant returns to the Funds, but which involve a substantial degree of risk. Funds may lose their entire investment in a troubled company, may be required to accept cash or securities with a value less than their investment and may be prohibited from exercising certain rights with respect to such investment. Troubled company investments may not show any returns for a considerable period of time. Funding a plan of reorganization involves additional risks, including risks associated with equity ownership in the reorganized entity. Troubled company investments may be adversely affected by state and federal laws relating to, among other things, fraudulent conveyances, voidable preferences, lender liability and the U.S. Bankruptcy Court's discretionary power to disallow, subordinate or disenfranchise particular claims. Investments in securities and private claims of troubled companies made in connection with an attempt to influence a restructuring proposal or plan of reorganization in a bankruptcy case may also involve substantial litigation.

**Special Situations.** Funds may invest in companies involved in (or the target of) acquisition attempts or tender offers or in companies or sovereign debt involved in work-outs, liquidations, spin-offs, reorganizations, bankruptcies and similar transactions. In any investment opportunity involving any such type of special situation, there exists the risk that the contemplated transaction either will be unsuccessful, take considerable time or will result in a distribution of cash or a new security the value of which will be less than the purchase price of the security or other financial instrument in respect of which such distribution is received. Similarly, if an anticipated transaction does not in fact occur, the Fund may be required to sell its investment at a loss. Because there is substantial uncertainty concerning the outcome of transactions involving financially troubled companies in which a Fund may invest, there is a potential risk of loss by the Fund of its entire investment in such companies.

**Small to Medium Capitalization Companies.** Knighthead may invest a significant portion of a Fund's assets in the stocks of companies with small to medium-sized market capitalizations. While smaller and medium sized companies generally have potential for rapid growth, they often involve higher risks because they may lack the management experience, financial resources, product diversification, and competitive strength of larger companies. In addition, in many instances, the frequency and volume of their trading may be substantially less than is typical of larger companies. Such companies may not be well-known to the investing public, may not have significant institutional ownership and may have cyclical, static or only moderate growth prospects. As a result, the securities of smaller and medium sized companies may be subject to wider price fluctuations. When making large sales, a Fund may have to sell portfolio holdings at discounts from quoted prices or may have to make a series of small sales over an extended period of time due to the lower trading volume of smaller and medium sized company securities.

Smaller and medium capitalization securities may be followed by relatively few securities analysts with the result that there tends to be less publicly available information concerning these securities compared to what is available for exchange-listed or larger companies. The securities of these companies may have limited trading volumes and may be subject to more abrupt or erratic market movements than the securities of larger, more established companies or the market averages in general, and the Fund may be required to deal

with only a few market makers when purchasing and selling these securities. Transaction costs in smaller capitalization stocks may be higher than those for larger-capitalized companies.

**Loans.** An investment in interests in syndicated, commercial bank loans, whether acquired through assignment or participation, may involve certain risks. Under the agreements governing most syndicated loans, should a Fund, as a holder of an interest in a syndicated loan, wish to call a default or exercise remedies against a borrower, it could not do so without the agreement of at least a majority of the other lenders. Further, actions could be taken by a majority of the other lenders, or in some cases, a single agent bank, without the consent of the Fund. The Fund would, nevertheless, be liable to indemnify the agent bank for the Fund's ratable share of expenses or other liabilities incurred in such connection and, generally, with respect to the administration and any renegotiation or enforcement of the syndicated loans. Moreover, an assignee or participant in a loan may not be entitled to certain gross-up payments in respect of withholding taxes and other indemnities that otherwise might be available to the original holder of the loan.

If an interest is acquired through a participation, the Fund would, to some extent, bear the credit risk not only of the distressed company borrower, but of the financial institution from which the participation is acquired. Further, in most cases, the holder of a participation will be bound by the actions or omissions of the seller of the participation and will be liable to indemnify the seller against expenses and liabilities allocable to the portion of the loan represented by the participation.

The value of the Fund's investment in loans (and hence, each limited partner's investment) may be detrimentally affected to the extent a borrower defaults on its obligations, there is insufficient collateral and/or there are extensive legal and other costs incurred in collecting on a defaulted loan. Knighthead may attempt to minimize this risk by maintaining low loan-to-liquidation values with each loan and the collateral underlying the loan. However, there can be no assurance that the value assigned by Knighthead to collateral underlying a loan of a Fund can be realized upon liquidation, nor can there be any assurance that collateral will retain its value. In addition, certain loans may be supported, in whole or in part, by personal guarantees made by the borrower or a relative, or guarantees made by a corporation affiliated with the borrower. The amount realizable with respect to a loan may be detrimentally affected if a guarantor fails to meet its obligations under the guarantee. Moreover, the value of collateral supporting loans may fluctuate. In addition, active lending/origination by a Fund may subject it to additional regulation, as well as possible adverse tax consequences. Finally, there may be a monetary, as well as a time cost involved in collecting on defaulted loans and, if applicable, taking possession of and subsequently liquidating various types of collateral.

**Bankruptcy Cases and Insolvent Companies.** Many of the events within a bankruptcy case can be adversarial and outcomes may be beyond the control of the creditors. While creditors generally have standing and are afforded an opportunity to object to significant actions, in a bankruptcy case there can be no assurance that a bankruptcy court will refrain from issuing rulings or approving certain actions contrary to the interests of particular creditors (including a Fund) or groups of creditors.

A Fund may invest in bankruptcy claims, which are amounts owed to creditors of companies operating under bankruptcy protection. Bankruptcy claims generally are relatively illiquid and do not pay interest unless fully secured, and there can be no guarantee that the debtor will ever be able to satisfy its obligation with respect to a bankruptcy claim. The markets in bankruptcy claims are not generally regulated by federal securities laws, the SEC or other regulatory agencies. Bankruptcy claims are frequently general unsecured claims, and holders of such claims receive distributions only from unencumbered cash or property (if any) remaining after all secured claims and certain priority unsecured claims have been satisfied. In addition, if the debtor has a fraudulent conveyance or preference action against the seller of the claim, the debtor may not be obligated to make any distribution on such a claim until the resolution of any such actions.

If a Fund purchased debt owed by a subsidiary company to its parent, in certain jurisdictions, such a purchase of debt from a shareholder may be re-categorized as financial support and become subject to equitable subordination (as defined below). This means that the rights of the creditor in respect of the debt will be subordinated to the claims of other creditors in the event of the company's insolvency.

Generally, the duration of a bankruptcy case can only be roughly estimated. The reorganization of a company usually involves the development and negotiation of a plan of reorganization, plan approval by creditors and confirmation or sanction by the applicable bankruptcy or other court. This process can involve substantial legal, professional and administrative costs to the company and its creditors (including a Fund). The bankruptcy process is subject to unpredictable and lengthy delays. In addition, the company may find it difficult to secure financing during the reorganization, and during the process the company's competitive position may erode, key management may depart and the company may not be able to operate adequately. In some cases, the company may not be able to reorganize and may be required to liquidate its assets. Investments in the debt of companies undergoing financial reorganization in bankruptcy will, in many cases, not pay current interest, may not accrue interest during reorganization and may be adversely affected by an erosion of the issuer's fundamental valuation. Such investments can result in a total loss of principal. In certain jurisdictions, including the United States, a company undergoing a reorganization or restructuring of its creditor obligations may classify its creditors' claims for purpose of voting on a plan of reorganization, composition, scheme or other similar insolvency proceeding. Because the standard for classification is vague, there exists a risk that the Fund's influence with respect to negotiations or voting by a class of securities it holds (directly or indirectly) may be limited as a result of the debtor's inclusion in or exclusion from the class of certain other creditors or equity security holders. In addition, certain administrative (post-bankruptcy) costs and other priority (pre-bankruptcy) claims (for example, claims for certain types of taxes), with seniority in the right to payment versus the claims of general unsecured creditors or equity security holders, may be quite high. A Fund may invest in companies based in Organisation for Economic Cooperation and Development ("OECD") and other non-U.S. countries. Investment in the debt of financially distressed companies domiciled outside the United States involves additional risks, including those risks discussed above. Insolvency and bankruptcy laws and processes may also differ substantially from those in the United States, resulting in greater uncertainty as to the rights of creditors, the enforceability of such rights, reorganization timing and the classification, seniority and treatment of claims. The procedural and substantive provisions of certain European

insolvency laws generally are more favorable to secured creditors than comparable provisions of U.S. law and afford debtors and unsecured creditors only limited protection from secured creditors. In certain developing countries, although bankruptcy laws have been enacted, the process for reorganization remains highly uncertain. Knighthead, on behalf of a Fund, may elect to serve on creditors' committees, equity holders' committees or other groups (both "official" and "ad hoc") to ensure preservation or enhancement of a Fund's position as a creditor or equity holder. A member of any such official committee owes fiduciary obligations generally to all of the committee's constituents. If Knighthead concludes that these fiduciary duties conflict with its duties owed to a Fund, it will resign from that committee or group, and the Fund may not realize the benefits, if any, of participation on the committee or group.

In addition, and also as discussed above, if a Fund is represented on a committee or group, it may be restricted or prohibited under applicable law from disposing of or increasing its investments in such company while it continues to be represented on such committee or group and may be subject to certain disclosure requirements regarding its investments in the applicable company. In addition, regardless of whether Knighthead is serving on an "official" or "ad hoc" committee, a Fund's ability to dispose of or increase its investments in such company may be limited by any so-called "securities trading order" entered by the applicable bankruptcy or other court. A securities trading order limits certain trading in the company's equity and, occasionally debt securities for purposes of protecting the company's ability to utilize its net operating loss carryovers to offset future tax liability. The effect of the order, however, often is to restrict trading in the applicable company's securities.

A Fund may purchase creditors' claims subsequent to the commencement of a bankruptcy case. Under judicial decisions, it is possible that such purchase may be unwound by a court if the court determines that the purchaser has taken unfair advantage of an unsophisticated seller, which may result in the rescission of the transaction (presumably at the original purchase price) or forfeiture by the purchaser.

Under common law principles that may also underlie lender liability claims, if a lender (a) intentionally takes an action that results in the undercapitalization of a borrower or issuer to the detriment of other creditors of such borrower or issuer, (b) engages in other inequitable conduct to the detriment of such other creditors, (c) engages in fraud with respect to, or makes misrepresentations to, such other creditors or (d) uses its influence as a stockholder to dominate or control a borrower or issuer to the detriment of other creditors of such borrower or issuer, a court may elect to subordinate the claim of the offending lender or bondholder to the claims of the disadvantaged creditor or creditors (a remedy called "**equitable subordination**").

No Fund intends to engage in conduct that would form the basis for a successful cause of action based upon the equitable subordination doctrine; however, because of the nature of the debt obligations in which a Fund may invest, the Fund may be subject to claims from creditors of an obligor that the Fund's claims against the obligor should be equitably subordinated.

**Chapter 11 Reorganizations.** Generally, the Chapter 11 reorganization process, while often lengthy and contentious, is ultimately resolved by consent. In order to achieve a consensual plan and expedite distributions, secured and other senior debt holders may agree to allocate value, which would otherwise be allocated to them on a strict priority basis, to junior creditors

who would not otherwise be entitled to such value or even anything at all. If this occurs, secured and other senior creditors may receive smaller distributions than they would otherwise be entitled to under a strict priority plan, although the present value of the reduced distributions could exceed the present value of full distributions made some years later.

On the other hand, in some circumstances, holders of senior claims are unwilling to forego their absolute priorities. Senior claim holders may attempt to have their plan of reorganization approved by using the “cram down” process described below despite the risk of protracted litigation and the consequent delay in receiving distributions. A proposed plan of reorganization will be confirmed by a bankruptcy court, if, among other things, every class of creditors accepts the plan. A class of creditors has accepted a plan if at least two-thirds in amount and more than one-half in number of the allowed claims of voting creditors in such class vote to accept the plan. Acceptance by a class binds each creditor in such class. A proposed plan of reorganization will be confirmed despite the rejection by one or more dissenting classes if at least one class of creditors has accepted the plan and the plan provides that all remaining classes are dealt with based on the seniority of their claims, with each class to be paid in full before the next junior class of creditors are paid anything. In this “cram down” scenario, to the extent that a Fund holds claims that are junior to those of any dissenting class or classes, it could realize little or nothing on such claims.

**Investor Activism.** A Fund may from time to time actively seek to influence the management or business direction of some of its portfolio companies. A Fund may invest in a particular company based upon its belief that the company’s business and operations could improve as a result of such Fund’s influence. Alternatively, it is possible that Knighthead may deem it necessary to seek representation for the Fund on the Board of Directors of, or on official or unofficial creditors’ committees for, a company in order to better monitor the financial condition of the company or developments in the proceeding and/or to be in an improved position of advocacy during any negotiations. If the company then resists the Fund’s efforts to influence it, the company may suffer poor business performance as a result, with correspondingly disappointing investment results for the Fund. Alternatively, the Fund’s proposed strategy may prove to be unwise or misguided, and the company may adopt that strategy to its detriment. Even if the strategy is adopted and is successful, a substantial period of time may elapse between the Fund’s purchase of the investment and the achievement of the anticipated results. There also may be instances where the Fund will be restricted in transacting in or withdrawing a particular investment as a result of its activist investment strategy. Moreover, as a result of the Fund’s investment strategy and the possibility that the Fund may participate in restructuring or similar activities, it is possible that the Fund may become involved in litigation (as either plaintiff or defendant). Litigation entails expense and the possibility of claims for damages against the Fund and ultimately judgments may be rendered against the Fund.

**Control Positions.** To the extent that a Fund owns a controlling stake in, has representatives on a board of directors or is deemed an affiliate of, a particular company, it may be subject to certain additional securities law restrictions which could affect both the liquidity of the Fund’s interest and the Fund’s ability to liquidate its interest without adversely impacting the stock price, including insider trading restrictions, the affiliate sale restrictions of Rule 144 of the Securities Act, and the disclosure requirements of Sections 13 and 16 of the Securities Exchange Act of 1934, as amended (the “**Exchange Act**”). In addition, to the extent that affiliates of the

Fund or Knighthead are subject to such restrictions, the Fund, by virtue of its affiliation with such entities, may be similarly restricted, regardless of whether it stands to benefit from such affiliate's stock ownership.

If the Fund, alone or as part of a group acting together for certain purposes, becomes the beneficial owner of more than 10% of certain classes of securities of a U.S. public company or places a director on the board of directors of such a company, it may be subject to certain additional reporting requirements and to liability for short-swing profits under Section 16 of the Exchange Act. Furthermore, the Fund may also be subject to similar reporting requirements in non-U.S. jurisdictions where it holds significant positions in the securities of public companies in such jurisdictions.

**Risk of Investing in Distressed Assets.** A Fund may invest in securities of enterprises that are experiencing or have experienced significant financial or business difficulties (including as the result of the initiation or prospect of significant litigation or a bankruptcy case). Investments may include loans, bank debt, commercial paper, trade or other claims held by trade or other creditors, equity securities, partnership interests, swaps (including credit default swaps), private equity investments, and similar financial, derivative or other instruments, executory contracts and options, rights or participations in any of the foregoing, which are not publicly traded.

Distressed securities may generate significant returns to a Fund, but also involve a substantial degree of risk. The Fund may lose a substantial portion or all of its investment in a distressed company or may be required to accept cash, securities or other property with a value less than the Fund's original investment. Among the risks inherent in investments in entities experiencing significant financial or business difficulties is the frequent difficulty of obtaining information as to the true condition of such entities. Such investments also may be adversely affected by state and federal laws and the laws of non-U.S. jurisdictions relating to, among other things, fraudulent transfers, voidable preferential payments, lender liability and the legal or equitable power of bankruptcy courts, regulatory agencies or other government bodies to disallow, subordinate or disenfranchise particular claims. The market prices of such instruments are also subject to abrupt and erratic market movements and above average price volatility, and the spread between the bid and asked prices of such instruments may be greater than for nondistressed securities. In trading distressed securities, litigation is sometimes required to realize on the investment. Such litigation can be time-consuming and expensive, and can frequently lead to unpredicted delays or losses. Moreover, it may sometimes be difficult to enforce and collect on these obligations, through litigation or otherwise.

In liquidation (both in and out of bankruptcy court) and other forms of corporate workouts and reorganizations, there exists the risk that the restructuring either will be unsuccessful (due to, for example, failure to obtain requisite acceptances of the reorganization plan), will be delayed (for example, while parties negotiate a plan of reorganization or litigate objections to such a plan) or will result in a distribution to the Fund of cash, a new security or other property, the value of which will be less than the purchase price of the security in respect of which such distribution was made.

It is anticipated that certain debt instruments purchased by Knighthead for the Fund will be non-performing and possibly in default. There can be no assurance as to the amount and timing of payments, if any, with respect to such debt instruments or other investments.

**High Yield Securities.** A Fund may make significant investments in “high yield” bonds and preferred securities which are rated in the lower rating categories by the various credit rating agencies (or in comparable non-rated securities). Securities in the lower rating categories are subject to greater risk of loss of principal and interest than higher-rated securities and are generally considered to be predominantly speculative with respect to the issuer’s capacity to pay interest and repay principal. They are also generally considered to be subject to greater risk than securities with higher ratings in the case of deterioration of general economic conditions. Because investors generally perceive that there are greater risks associated with lower-rated securities, the yields and prices of such securities may tend to fluctuate more than those for higher-rated securities.

**Risk of Event-Driven Investments.** A Fund may invest in companies involved in or undergoing work-outs, liquidations, spin-offs, reorganizations, bankruptcies or other changes or similar transactions. In any investment opportunity involving any such type of special situation, there exists the risk that the contemplated transaction either will be unsuccessful, take considerable time or will result in a distribution to the Fund of cash or a new security, the value of which will be less than the purchase price of the security in respect of which such distribution is received. Similarly, if an anticipated transaction does not in fact occur, the Fund may be required to sell its investment at a loss. Because there is substantial uncertainty concerning the outcome of transactions involving financially troubled companies in which the Fund may invest, there is a potential risk of loss by the Fund of its entire investment in such companies.

Event-driven investing requires the investor to make predictions about (i) the likelihood that an event will occur, (ii) the impact such event will have on the value of a particular investment and (iii) the timing of such event. If the event fails to occur or it does not have the effect foreseen, losses can result. For example, the adoption of new business strategies or completion of asset dispositions or debt reduction programs by a company may not be valued as highly by the market as Knighthead had anticipated, resulting in losses. In addition, a company may announce a plan of restructuring which promises to enhance value, but fail to implement it, which can result in losses. In liquidations and other forms of corporate reorganization, the risk exists that the reorganization either will be unsuccessful, will be delayed or will result in a distribution to the Fund of cash or a new security, the value of which will be less than the purchase price of the security in respect of which such distribution was made. The consummation of mergers and tender and exchange offers can be prevented or delayed by a variety of factors. Because of the inherently speculative nature of event-driven investing, the results of the Fund’s operations may be expected to fluctuate from period to period. Accordingly, the results of a particular period will not necessarily be indicative of results that may be expected in future periods.

**Risk of Investing in Bank Debt.** A Fund’s investment program may include investments in significant amounts of bank debt and participations. These obligations are subject to unique risks, including: (i) the possible invalidation of an investment transaction as a fraudulent conveyance under relevant creditors’ rights laws; (ii) so-called lender-liability claims

by the issuer of the obligations; (iii) environmental liabilities that may arise with respect to collateral securing the obligations; and (iv) limitations on the ability of the Fund to directly enforce its rights with respect to participations. In analyzing bank debt transactions or participations, Knighthead compares the relative significance of the risks against the expected benefits of the investment. Successful claims by third parties arising from these and other risks will be borne by the Fund.

From time to time the Fund may incur contingent liabilities in connection with bank debt or similar investments. For example, the Fund may purchase from a lender a revolving credit facility that has not yet been fully drawn. If the borrower subsequently draws down on the facility, the Fund would be obligated to fund the amounts due.

Purchasers of bank debt are predominantly commercial banks, investment funds, mutual funds and investment banks. As secondary market trading volumes increase, issuers of new bank debt are increasingly adopting standardized documentation to facilitate bank debt trading, which may improve market liquidity. There can be no assurance, however, that future levels of supply and demand in bank debt trading will provide an adequate degree of liquidity or that the current level of liquidity will continue. Because of the provision to holders of such bank debt of confidential information relating to the borrower, the unique and customized nature of the bank debt agreement and the private syndication of bank debt, bank debt is not as easily purchased or sold as a publicly traded security, and historically the trading volume in the bank debt market has been small relative to the high yield debt market.

Investing in bank debt involves the risk to the Fund that misrepresentations or omissions on the part of the borrower could adversely affect the valuation of the collateral underlying the loans or may adversely affect the ability of the Fund to perfect or effectuate a lien on the collateral securing the bank debt. The Fund will rely upon the accuracy and completeness of representations made by borrowers to the extent reasonable, but cannot guarantee such accuracy or completeness. Under certain circumstances, payments to the Fund may be reclaimed if any such payment or distribution is later determined to have been a fraudulent conveyance or a preferential payment.

**Emerging Markets.** Investing in emerging market debt or equity involves certain risks and special considerations not typically associated with investing in other more established economies or securities markets. Such risks may include (a) the risk of nationalization or expropriation of assets or confiscatory taxation; (b) social, economic and political uncertainty including war; (c) dependence on exports and the corresponding importance of international trade; (d) price fluctuations, less liquidity and smaller capitalization of securities markets; (e) currency exchange rate fluctuations; (f) rates of inflation (including hyperinflation); (g) controls on foreign investment and limitations on repatriation of invested capital and on the Fund's ability to exchange local currencies for U.S. dollars; (h) governmental involvement in and control over the economies; (i) governmental decisions to discontinue support of economic reform programs generally and to impose centrally planned economies; (j) differences in auditing and financial reporting standards which may result in the unavailability of material information about issuers; (k) less extensive regulation of the securities markets; (l) longer settlement periods for securities transactions; (m) less developed corporate laws regarding fiduciary duties of officers and directors and the protection of investors; and (n) certain considerations regarding the

maintenance of Fund's portfolio securities and cash with non-U.S. sub-custodians and securities depositories.

**Warrants.** Warrants are derivative instruments that permit, but do not obligate, the holder to subscribe for other securities. Warrants do not carry with them the right to dividends or voting rights with respect to the securities that they entitle the holder to purchase, and they do not represent any rights in the assets of the issuer. As a result, warrants may be considered more speculative than certain other types of investments. In addition, the value of a warrant does not necessarily change with the value of the underlying securities or commodities, and a warrant ceases to have value if it is not exercised prior to its expiration date.

**Credit Default Swap Agreements.** The "buyer" in a credit default contract is obligated to pay the "seller" a periodic stream of payments over the term of the contract in return for a contingent payment upon the occurrence of a credit event with respect to an underlying reference obligation. Generally, a credit event means bankruptcy, failure to pay or obligation acceleration. If a credit event occurs, the seller typically must pay the contingent payment to the buyer, which is typically the "par value" (full notional value) of the reference obligation. The contingent payment may be a cash settlement or by physical delivery of the reference obligation in return for payment of the face amount of the obligation. A Fund may be either the buyer or seller in the transaction. If the Fund is a buyer and no credit event occurs, the Fund may lose its investment and recover nothing. However, if a credit event occurs, the buyer typically receives full notional value for a reference obligation that may have little or no value. As a seller, the Fund receives a fixed rate of income throughout the term of the contract, which typically is between one month and five years, provided that no credit event occurs. If a credit event occurs, the seller may pay the buyer the full notional value of the reference obligations.

Credit default swaps involve greater risks than if the Fund had invested in the reference obligation directly. In addition to general market risks, credit default swaps are subject to liquidity risk and credit risk. A buyer also may lose its investment and recover nothing should no credit event occur. If a credit event were to occur, the value of the reference obligation received by the seller, coupled with the periodic payments previously received, may be less than the full notional value it pays to the buyer, resulting in a loss of value to the Fund. In certain circumstances, the buyer can receive the notional value of a credit default swap only by delivering a physical security to the seller, and is at risk if deliverable security is unavailable or illiquid.

**Debt Securities; Lower-Rated Securities.** A Fund may invest in fixed income securities and other debt securities or instruments. Investing in lower-rated securities involves special risks in addition to the risks associated with investments in higher-rated fixed income securities, including a high degree of credit risk and increased risks in the case of deterioration of general economic conditions. Lower-rated securities may be regarded as predominately speculative with respect to the issuer's continuing ability to meet principal and interest payments. Funds may invest in debt securities which rank junior to other outstanding securities and obligations of the issuer, all or a significant portion of which may be secured on substantially all of that issuer's assets. Funds may invest in debt securities which are not protected by financial covenants or limitations on additional indebtedness. In addition, the market for credit spreads is often inefficient and illiquid, making it difficult to accurately calculate discounting spreads for

valuing financial instruments. Analysis of the creditworthiness of issuers/issues of lower-rated securities may be more complex than for issuers/issues of higher quality debt securities. Lower-rated securities may be more susceptible to losses and real or perceived adverse economic and competitive industry conditions than higher-grade securities. Securities that are in the lowest rating category are considered to have extremely poor prospects of ever attaining any real investment standing, to have a current identifiable vulnerability to default, and to be unlikely to have the capacity to pay interest and repay principal. Because investors generally perceive that there are greater risks associated with lower-rated securities, the yields and prices of such securities may tend to fluctuate more than those for higher-rated securities.

The secondary markets on which lower-rated securities are traded may be less liquid than the market for higher-grade securities, which can adversely affect the prices at which these securities can be sold. Less liquidity in the secondary trading markets could therefore adversely affect and cause large fluctuations in the value of the Fund's portfolio. Adverse publicity and investor perceptions, whether or not based on fundamental analysis, may decrease the values and liquidity of lower-rated securities, especially in a thinly traded market. Furthermore, with respect to certain residential and commercial mortgage-backed securities, it is difficult to obtain current reliable information regarding delinquency rates, prepayment rates, servicing records, as well as updated cash flows.

**Interest Rate Risk.** Because Funds may invest in debt securities, they are subject to interest rate risk. Generally, the value of debt securities will change inversely with changes in interest rates. As interest rates rise, the market value of debt securities tends to decrease. Conversely, as interest rates fall, the market value of debt securities tends to increase. This risk will be greater for long-term securities than for short-term securities.

**Convertible Securities.** Funds may invest in convertible securities, securities that may be exchanged or converted into a predetermined number of the issuer's underlying shares or the shares of another company or that are indexed to an unmanaged market index at the option of the holder during a specified time period. Convertible securities may take the form of convertible preferred stock, convertible bonds or debentures, stock purchase warrants, zero-coupon bonds or liquid-yield option notes, stock index notes, mandatories, or a combination of the features of these securities. Prior to conversion, convertible securities have the same general characteristics as non-convertible debt securities. As with all debt securities, the market value of convertible securities tends to decline as interest rates increase and conversely, increase as interest rates decline. Convertible securities, however, also appreciate when the underlying common stock appreciates, and conversely, depreciate when the underlying common stock depreciates. Further, convertible securities may involve certain risks which are not present with respect to a standard purchase of common stock. Convertible securities may contain restrictions on the number of securities that may be converted at any one time or restrictions on the Fund's ability to hedge such securities. The risks may include, but are not limited to, the risk that the issuer may pay dividends to its limited partners without any compensation being paid to the convertible holders and uncertainty regarding the treatment of convertibles in the event the issuer is acquired or merged with another entity (i.e., whether the conversion rights will be protected and ongoing into the new legal entity).

**Risk of Investing in Trade Claims and Similar Claims.** The Fund invests in unsecured claims held by entities owed for goods, services or other losses against companies that have filed for bankruptcy protection (such claims are known as “**Trade Claims**”). Because of the absence of a regulated market for Trade Claims and the decreased transparency of pricing information with respect to Trade Claims (and the resulting difficulties in determining market values for them) as well as the risk that such claims may be disallowed or reduced by the bankruptcy court or treated differently from other forms of debt under the debtor’s plan of reorganization approved by the bankruptcy court, the prices and/or returns realized on such investments could be less than the price originally paid by the Fund. Further, because of the absence of a formal market, indices, or regulation of Trade Claims, Trade Claims may be illiquid. The purchaser of a Trade Claim (such as the Fund) may also be subject to actions during the bankruptcy court proceedings, including preference actions and, in certain circumstances, equitable subordination actions, based solely on prior conduct of the seller of such Trade Claim. Such actions may result in the reduction or disallowance of a Trade Claim and losses to the purchaser of such claim, and a delay of realization of the value of such Trade Claim. Further, in the event a seller of a Trade Claim subsequently becomes insolvent or itself files for bankruptcy protection, the purchaser of such claim may not benefit from any warranties, representations or indemnities provided by the seller to the purchaser in the purchase documents (including recourse for disallowed claims), and, with respect to insolvent claim sellers, be subject to credit and litigation risk. Trade Claims are also subject to the credit and recovery risk of the bankrupt company, as well as the general risks associated with bankruptcy cases. In the event these risks materialize with respect to Trade Claims purchased by the Fund, the Fund may suffer significant losses. The purchaser of a Trade Claim (such as the Fund) may also be subject to the risk that the seller of a Trade Claim will fail to deliver upon the terms of the investment. In addition, the Trade Claims market lacks standard documentation, which increases settlement risks.

**Lack of Diversification.** Generally, a Fund’s portfolio may not be diversified among a wide range of issuers, types of securities or geographic areas. Accordingly, the Fund’s investments may be subject to more rapid change in value than would be the case if the Fund were required to maintain a wide diversification among issuers, types of securities and geographic areas.

**Currency Risks.** The investments that are denominated in non-U.S. currencies are subject to the risk that the value of a particular currency will change in relation to one or more other currencies. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments. Knighthead may try to hedge these risks by investing in currencies and options thereon, forward currency exchange contracts, or any combination thereof, but there can be no assurance that such strategies will be implemented or, if implemented, will be effective.

**Counterparty and Creditworthiness Risk.** Funds will engage in transactions in securities, commodities and/or other financial instruments that involve counterparties, and no counterparty exposure limits have been imposed on these transactions. Under certain conditions, a counterparty to a transaction could default or the market for certain securities, commodities and/or other financial instruments may become illiquid. In addition, a Fund could suffer losses if there were a default or bankruptcy by third parties, including, without limitation, brokerage firms

and banks with which the Fund does business, or to which securities have been entrusted for custodial purposes.

The loan counterparties with which the Fund may effect transactions may not be subject to credit evaluation and regulatory oversight as are members of “exchange-based” markets. In addition, many of the protections afforded to participants on some organized exchanges, such as the performance guarantee of an exchange clearinghouse, will not be available in connection with Fund’s lending activities. This exposes the Fund to the risk that a counterparty will not settle a transaction in accordance with its terms and conditions because of a dispute over the terms of the contract (whether or not bona fide) or because of a credit or liquidity problem, thus subjecting the Fund to suffer a possible loss. Such “counterparty risk” is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where the Fund has concentrated its transactions with a single or small group of counterparties. The Fund is not restricted from dealing with any particular counterparty or from concentrating any or all of its transactions with one counterparty. The ability of the Fund to transact business with any one or number of counterparties, the lack of any meaningful and independent evaluation of such counterparties’ financial capabilities and the absence of a regulated market to facilitate settlement may increase the potential for losses by the Fund. Knighthead intends to diversify and mitigate counterparty risk as appropriate.

**Custody and Prime Brokerage Risk.** There are risks involved in dealing with the custodians or prime brokers who settle Fund trades. Under certain circumstances, the securities and other assets deposited with the custodian or broker may not be clearly identified as being assets of the Fund and hence the Fund could be exposed to a credit risk with regard to such parties. In addition, there may be practical or time problems associated with enforcing the Fund’s rights to its assets in the case of an insolvency of any such party. The investment strategy of a Fund may require Knighthead to actively trade the Fund’s portfolio, and if as a result of the insolvency of the custodian or prime broker, Knighthead is not able to actively trade the Fund’s portfolio for some period of time, the Fund could be significantly adversely affected. Further, there are certain risks involved with certain of the Fund’s assets, such as bank loans, which are not held by a custodian.

The Funds maintain custody accounts with their prime brokers and primary custodians, Goldman, Sachs & Co. and J.P. Morgan Securities, Inc. (collectively, the “**Prime Brokers**”). Although Knighthead will monitor the Prime Brokers and believes that they are appropriate custodians, there is no guarantee that the Prime Brokers, or any other custodian (see **Item 15. Custody** for complete list of custodians) that the Funds may use from time to time, will not become insolvent. While both the U.S. Bankruptcy Code and the Securities Investor Protection Act of 1970 seek to protect customer property in the event of a failure, insolvency or liquidation of a broker-dealer, there is no certainty that, in the event of a failure of a broker-dealer that has custody of Fund assets, the Fund would not incur losses due to its assets being unavailable for a period of time, ultimately less than full recovery of its assets, or both.

A Fund and/or the Prime Brokers may appoint sub-custodians in certain non-U.S. jurisdictions to hold the assets of the Fund. The Prime Brokers may not be responsible for cash or assets which are held by sub-custodians in certain non-U.S. jurisdictions, nor for any losses suffered by a Fund as a result of the bankruptcy or insolvency of any such sub-custodian. A Fund

may therefore have a potential exposure on the default of any sub-custodian and, as a result, many of the protections which would normally be provided by a custodian will not be available to the Fund. Custody services in certain non-U.S. jurisdictions remain undeveloped and, accordingly, there is a transaction and custody risk of dealing in certain non-U.S. jurisdictions. Given the undeveloped state of regulations on custodial activities and bankruptcy in certain non-U.S. jurisdictions, the ability of the Fund to recover assets held by a sub-custodian in the event of the sub-custodian's bankruptcy would be in doubt.

**Commodities and Futures Contracts.** Trading in commodities and futures contracts are highly specialized activities that may entail greater than ordinary investment risks. Commodity futures markets (including financial futures) are highly volatile and are influenced by factors such as changing supply and demand relationships, governmental programs and policies, national and international political and economic events and changes in interest rates. In addition, because of the low margin of deposit normally required in commodity futures trading, a high degree of leverage is typical of a commodity futures trading account. Consequently, a relatively small price movement in a commodity futures contract may result in substantial losses to the trader. Commodity futures trading may also be illiquid. Certain commodity exchanges do not permit trading in a particular type of future beyond certain set limits. If prices fluctuate during a single day's trading beyond those limits – which conditions have in the past sometimes lasted for several days in certain contracts – a Fund could be prevented from promptly liquidating unfavorable positions and thus be subject to substantial losses.

**Lack of Liquidity of Investments.** Funds may invest in non-publicly traded securities and private debt instruments for which the number of potential purchasers and sellers, if any, is very limited. This factor may have the effect of limiting the availability of these securities for purchase by the Fund and may also limit the ability of the Fund to sell such securities at their fair market value in response to changes in the economy or financial markets. The sale of any such investments may be possible only at substantial discounts. Thus, there can be no assurance as to the timing and amount of distributions from the Fund.

**Investments in Undervalued Securities.** Knighthead intends to invest Fund capital in undervalued securities. The identification of investment opportunities in undervalued securities is a difficult task, and there are no assurances that such opportunities will be successfully recognized or acquired. While investments in undervalued securities offer the opportunities for above-average capital appreciation, these investments involve a high degree of financial risk and can result in substantial losses. Returns generated from a Fund's investments may not adequately compensate for the business and financial risks assumed. The Fund will make certain speculative investments in securities which Knighthead believes to be undervalued; however, there are no assurances that the securities purchased will in fact be undervalued. In addition, the Fund may be required to hold such securities for a substantial period of time before realizing their anticipated value. During this period, a portion of the Fund's assets would be committed to the securities purchased, thus possibly preventing the Fund from investing in other opportunities.

**Inflation Risk.** Inflation risk results from the variation in the value of cash flows from a security due to inflation, as measured in terms of purchasing power. For example, if a Fund purchases a 5-year bond in which it can realize a coupon rate of five percent (5%), but the rate of inflation is six percent (6%), then the purchasing power of the cash flow has declined. For all but

inflation linked bonds, adjustable bonds or floating rate bonds, the Fund, if it were to invest in bonds, would be exposed to inflation risk because the interest rate the issuer promises to make is fixed for the life of the security. To the extent that interest rates reflect the expected inflation rate, floating rate bonds have a lower level of inflation risk.

**Systemic Risk.** World events and/or the activities of one or more large participants in the financial markets and/or other events or activities of others could result in a temporary systemic breakdown in the normal operation of financial markets. Such events could result in a Fund losing substantial value caused predominantly by liquidity and counterparty issues, which could result in the Fund incurring substantial losses.

**General Economic Conditions.** The success of any investment activity is affected by general economic conditions, which include the level and volatility of interest rates, credit spreads and equity valuations and the extent and timing of investor participation in the markets for both equities and interest-sensitive instruments. Unexpected volatility or illiquidity in the markets in which the Funds hold positions could cause the Funds to incur losses.

**Trading Limitations.** For all securities and commodities, including options and regulated futures contracts listed on a public exchange, the exchange generally has the right to suspend or limit trading under certain circumstances, including the right to impose position limits and price limits on persons or groups of persons. Such suspensions or limits could render certain strategies difficult to complete or continue and subject the Funds to loss.

**Risk of Litigation.** From time to time, a Fund may be named as a defendant in a lawsuit or regulatory action. As a result of such action, the assets of the Fund may be frozen, and the Fund may not be able to liquidate its investments. In certain cases, the Fund, Knighthead and/or their respective affiliates may be called on to testify and/or provide information (including, without limitation, a list of investors in the applicable fund(s)) in connection with such lawsuit or regulatory action. The Fund may also be named as a defendant in the lawsuit or regulatory action. Litigation and regulatory actions can be time-consuming and expensive, and can frequently lead to unpredicted delays or losses.

**Cybersecurity.** The computer systems, networks and devices used by the Adviser and service providers to the Adviser and the Clients to carry out routine business operations employ a variety of protections designed to prevent damage or interruption from computer viruses, network failures, computer and telecommunication failures, infiltration by unauthorized persons and security breaches. Despite the various protections utilized, systems, networks, or devices potentially can be breached. The Clients and their investors could be negatively impacted as a result of a cybersecurity breach.

Cybersecurity breaches can include, but are not limited to, unauthorized access to systems, networks, or devices; infection from computer viruses or other malicious software code; and attacks that shut down, disable, slow, or otherwise disrupt operations, business processes, or website access or functionality. Cybersecurity breaches may cause disruptions and impact business operations, potentially resulting in financial losses to the Clients; interference with the ability to calculate the value of an investment in a fund or account; impediments to trading; The Advisor's inability and/or other service providers, to transact business; violations of applicable

privacy and other laws; regulatory fines, penalties, reputational damage, reimbursement or other compensation costs, or additional compliance costs; as well as the inadvertent release of confidential information and any other type of unforeseen result.

Similar adverse consequences could result from cybersecurity breaches affecting issuers of securities in which a Client invests; counterparties with which a Client engages in transactions; governmental and other regulatory authorities; exchange and other financial market operators, banks, brokers, dealers, insurance companies, and other financial institutions; and other parties. In addition, substantial costs may be incurred by these entities in order to prevent any cybersecurity breaches in the future.

### **Real Estate Funds' Investment Risks**

The Real Estate Funds will make investments based upon analyses of current returns and estimates and projections of property performance that may be available in potential investments. No assurance can be made that the Real Estate Funds will make investments that will realize its return objectives. The Real Estate Funds may not be successful in identifying suitable investments and assets that meet its investment criteria or in originating loans or making other investments on satisfactory terms or at all. Debt investments entail risks that investments may not perform in accordance with expectations. Failures in identifying investments on satisfactory terms or poor performance of any one investment could adversely affect the Real Estate Funds' performance. In addition, subsequent to the Real Estate Funds' acquisition of a particular investment, management may adjust targeted returns to reflect changes in market conditions. No assurance can be made that the Real Estate Funds will make a profit on its investments or even be able to recover its invested capital during any anticipated period of time. The Real Estate Funds' portfolio generally will consist of investments which may be subject to legal or other restrictions on transfer. As a consequence, the Real Estate Funds may not be able to sell its investments when it desires to do so or to realize what it perceives to be their fair value in the event of a sale.

**Investments Longer Than Term.** The Real Estate Funds may invest in investments that, due to subsequent events, may not be advantageously resolved or otherwise disposed of prior to the date that the Real Estate Funds will be dissolved, either by expiration of the Real Estate Funds' term or otherwise. Although the general partners of the Real Estate Funds expect that investments will either pay at maturity or be otherwise disposed of or realized upon prior to dissolution or be suitable for in-kind distribution at dissolution, the Real Estate Funds may have to sell, distribute, or otherwise dispose of investments at a disadvantageous time as a result of its dissolution.

If the Real Estate Funds are unable to realize on or liquidate its portfolio of investments by the end of its term, investors may receive distributions of real estate assets or loans as a liquidation distribution in respect of their interests. No guarantee or assurance can be given as to the marketability or liquidity of such real estate assets or loans or the effect that non-marketability or the lack of liquidity could have on the value of such loans or such investors' return on their investment in the Real Estate Funds.

**Lack of Operating Control of Underlying Investments.** The day-to-day operations of the properties underlying the loans that the Real Estate Funds originate will be the responsibility of the owners and developers of such properties. Although the general partners of the Real Estate Funds will be responsible for monitoring the performance of each investment and intends to originate loans related to underlying properties that are operated by strong management, there can be no assurance that the owners and developers will be able to operate the underlying properties in accordance with their business plans or the expectations of the Real Estate Funds.

**Competitive Nature of the Real Estate Funds' Business.** The activity of sourcing, underwriting and closing attractive real estate loans is competitive and involves a high degree of uncertainty. The Real Estate Funds may be competing for lending opportunities with entities that have substantially greater financial and other resources than the Real Estate Funds. Those entities may be able to accept more risk than the Real Estate Funds can prudently manage. Competition generally may reduce the number of suitable lending opportunities available to the Real Estate Funds and increase the bargaining power of prospective borrowers seeking to finance real estate. Other investment vehicles may enjoy significant competitive advantages that result from, among other things, a lower cost of capital and enhanced operating efficiencies. In addition, the number of entities and the amount of funds competing for suitable loans may increase. This will result in increased demand for these loans and, therefore, less attractive lending terms. As a result, no assurance can be made that the Real Estate Funds will be able to locate attractive lending opportunities that satisfy its investment objectives or realize their values or that the Real Estate Funds will be able to become fully invested for a significant period of time, if at all. Other investors may make competing offers for lending opportunities that are identified and, even after an agreement in principle has been reached with a prospective borrower, consummating the lending transaction is subject to numerous uncertainties, only some of which are foreseeable or within the control of the general partner of the Real Estate Funds. As a result of the competitive nature of the Real Estate Funds' lending activities, it may incur costs and expenses in pursuit of potential lending opportunities that are never consummated, which could reduce the returns to investors on such loans.

The Real Estate Funds may use leverage in connection with its investments and operations and no assurance exists that the Real Estate Funds will be able to obtain the necessary debt financing at acceptable terms. The use of leverage involves financial risk which increases the exposure of the Real Estate Funds' investment returns to adverse economic factors such as rising interest rates, downturns in the economy or deterioration in the condition of the investments. Principal and interest payments on indebtedness will have to be made regardless of the sufficiency of cash flow from the properties. A risk exists that operating cash flow available to the Real Estate Funds will be insufficient to meet required payments and a risk that it will not be possible to refinance existing indebtedness or that the terms of such refinancing will not be as favorable as the terms of existing indebtedness.

Borrowings by the Real Estate Funds may be secured by the assets of the Real Estate Funds. Defaults on indebtedness secured by these assets may result in foreclosure actions initiated by lenders and, ultimately, the Real Estate Funds' loss of such assets. In addition, the Real Estate Funds' investments may be impaired by a smaller decline in the value of the investments than is the case where investments are owned with a proportionately lower amount of debt. Depending on the level of leverage and decline in value, if the Real Estate Funds do not

make loan payments when due, one or more of the investments may be lost (and the Real Estate Funds' investment therein rendered valueless) as a result of such foreclosure by the lender.

**Interest Rate Risks.** Changes in interest rates may adversely affect the Real Estate Funds' investments. Changes in mortgage rates can directly affect the demand for and value of the real estate loans it holds or originates. Changes in the general level of interest rates can affect the Real Estate Funds' income by affecting the spread between the income on its assets and interest-bearing liabilities, as well as the value of its interest-earning assets and its ability to realize gains from the sale of assets. Interest rates are highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations, fiscal deficits, trade surpluses or deficits, regulatory requirements and other factors beyond the control of the Real Estate Funds. The Real Estate Funds may finance its activities with both fixed- and floating-rate debt. With respect to its floating-rate debt, the Real Estate Funds' performance may be affected adversely if it chooses not to implement a strategy to limit the effects of changes in interest rates on its operations by employing an effective hedging strategy, including engaging in interest rate swaps, caps, floors or other interest rate contracts or buying and selling interest rate futures or options on such futures.

**Deflationary Risk.** During extended periods of deflation, market rents and demand for real estate are generally expected to decline as well as replacement costs, which would be expected to cause a decline in the value of real estate. If the market enters a deflationary period the Real Estate Funds' investments may accordingly decline in value. If such investments are leveraged by the Real Estate Funds, any such decrease could result in a substantial or complete loss of the Real Estate Funds' equity investment.

**Lack of Diversification.** While the Real Estate Funds will endeavor to have a fair degree of diversification in its investments, both by geographic region and by collateral type, it does not expect that it will have any formal policy regarding diversification. Accordingly, there can be no assurance as to the degree of diversification that will actually be achieved in the Real Estate Funds' investments. The geographic concentration of the Real Estate Funds' mortgage loans will increase its exposure to risks in those areas from natural disasters, regional economic downturns or other localized adverse events.

**General Real Estate Risk.** The value of the real estate that underlies mortgage transactions is subject to market conditions. Changes in the real estate market may adversely affect the value of the collateral and thereby lower the value to be derived from a liquidation. In addition, adverse changes in the real estate market increase the probability of default, because the incentive of the borrower to retain equity in the property declines. Loans may become nonperforming for a wide variety of reasons, including, without limitation, because the mortgaged property is too highly leveraged (and, therefore, the property is unable to generate sufficient income to meet its debt service payments), the property is poorly managed or because the mortgaged property has a high vacancy rate, has not been fully completed or is in need of rehabilitation. Such nonperforming loans may require a substantial amount of workout negotiations and / or restructuring, which may entail, among other things, a substantial reduction in the interest rate, capitalization of interest payment and a substantial write-down of the principal of the loan. However, even if such restructuring were successfully accomplished, a risk

exists that upon maturity of such mortgage loan, replacement “take-out” financing will not be available.

It is likely that some of the real estate assets underlying the Real Estate Funds’ investments may be subject to foreclosure. The foreclosure process is often lengthy and expensive. Borrowers may resist mortgage foreclosure actions by asserting numerous claims, counterclaims and defenses, including lender liability claims and defenses, even when such assertions may have no basis in fact, in an effort to prolong the foreclosure action and force the lender into a modification of the loan or a favorable buy-out of the borrower’s position. In some states, foreclosure actions can sometimes take several years or more to litigate. At any time prior to or during the foreclosure proceedings the borrower may file for bankruptcy, which would have the effect of staying the foreclosure actions and further delaying the foreclosure process. Foreclosure litigation tends to create a negative public image of the mortgaged property and may result in disrupting the ongoing leasing, management and operation of the property.

**Loan Risks.** Loans in the Real Estate Funds will be generally secured by a variety of real property types, and may entail risks of delinquency and foreclosure, and risks of loss in the event thereof, may be greater than similar risks associated with loans made by traditional and conventional lenders. While loans made by conventional lenders generally depend upon a borrower’s ability to continue the successful operation of a property, the Real Estate Funds’ loans will generally depend upon a borrower’s ability to develop, redevelop or reposition a property and improve its cash flow. The ability of a borrower to execute on its proposed development, redevelopment or repositioning plans for a property will depend upon borrower’s ability to manage construction risks, changing market conditions, planning approvals, competition from comparable types of properties, changes in laws, the need to address environmental contamination at the property and the occurrence of any uninsured casualty at the property.

In the event of a default under a mortgage loan held by the Real Estate Fund, it bears a risk of loss to the extent of any deficiency between the value of the collateral (net of its collection costs) and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on the funds expected returns. In cases where the Real Estate Funds have mortgage loans that are recourse to the borrower, in the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law, which could have a negative effect on the Real Estate Funds’ anticipated return on the foreclosed loan. Further, foreclosing upon a loan can be very expensive, could subject the Real Estate Funds to environmental liabilities and may distract its management from its other operations.

The value of an income producing property is directly related to the net operating income derived from such property. Furthermore, rates of defaults and losses on commercial mortgage loans, and the value of any commercial property, may be adversely affected by risks generally incident to interests in real property, including various events which the related borrower and / or manager of the commercial property, may be unable to predict or control, such as changes in

general or local economic conditions and / or specific industry segments; declines in real estate values; declines in rental or occupancy rates; increases in interest rates, real estate tax rates and other operating expenses; changes in governmental rules, regulations and fiscal policies, including environmental legislation; acts of God; environmental hazards; and social unrest and civil disturbances. If a commercial mortgage loan is in default, foreclosure of such commercial mortgage loan may be a lengthy and difficult process, and may involve significant expenses. Furthermore, the market for defaulted commercial mortgage loans or foreclosed properties may be very limited.

**Assignments and Participations.** As with the Funds, the Real Estate Funds may acquire interests in bank loans or other non-Fund originated loans either directly (by way of assignment) or indirectly (by way of participation). The purchaser of an assignment typically succeeds to all the rights and obligations of the assigning institution and becomes a contracting party under the loan agreement with respect to the loan; however, its rights can be more restricted than those of the assigning institution. Participations in a portion of a loan typically result in a contractual relationship only with the institution participating out the interest and not with the obligor. The Real Estate Funds would, in such a case, have the right to receive payments of principal and interest to which it is entitled only from the institution selling the participation, and not directly from the obligor, and only upon receipt by such institution of such payments from the obligor. As the owner of a participation, the Real Estate Funds generally will have no right to enforce compliance by the obligor with the terms of the loan agreement or to vote on amendments to the loan agreement, nor any rights of set-off against the obligor, and the Real Estate Funds may not directly benefit from collateral supporting the loan in which it has purchased the participation. In addition, the Real Estate Funds may purchase a participation from a selling institution that does not own any portion of the applicable loan and, therefore, may have limited interest in monitoring the terms of the loan agreement and the continuing creditworthiness of the borrower. When the Real Estate Funds hold a participation interest in a loan, it is expected that each selling institution will reserve the right to administer the loan sold by it as it sees fit and to amend the documentation evidencing such loan in all respects. Selling institutions voting in connection with such matters may have interests different from those of the Real Estate Funds and may fail to consider the interests of the Real Estate Funds in connection with their votes. In addition, in the event of the insolvency of the selling institution under the laws of the United States and the states thereof, the Real Estate Funds may be treated as a general creditor of such selling institution, and may not have any exclusive or senior claim with respect to the selling institution's interest in, or the collateral with respect to, the applicable loan. Consequently, the Real Estate Funds will assume the credit risk of both the obligor and the institution selling the participation to the fund. As a result, concentrations of participations from any one selling institution may subject the Real Estate Funds to an additional degree of risk with respect to defaults by such selling institution. Assignments and participations are sold strictly without recourse to the selling institutions, and the selling institutions will generally make no representations or warranties about the underlying loan, the borrowers, the documentation of the loans or any collateral securing the loans. The participation interests in which the Real Estate Funds invest may not be rated by any nationally recognized rating service.

Investments in loans through a direct assignment of a financial institution's interests with respect to the loan may involve additional risks to the Real Estate Funds. For example, if a loan is foreclosed, the Real Estate Funds could become part owner of any collateral, and would bear

the costs and liabilities (including tax liabilities) associated with owning and disposing of the collateral. In addition, it is conceivable that, under emerging legal theories of lender-liability, the Real Estate Funds could be held liable as a co-lender. It is unclear whether loans and other forms of direct indebtedness offer securities laws protections against fraud and misrepresentation. In the absence of definitive regulatory guidance, the Real Estate Funds relies on the general partners' research in an attempt to avoid situations where fraud or misrepresentation could adversely affect it.

**Third-party Involvement.** The Real Estate Funds may make investments through joint ventures with unaffiliated third parties. Joint venture investments entail additional potential risks, including the risk that the Real Estate Funds will not be able to implement investment decisions or exit strategies because of limitations on its control of the property under applicable agreements with joint venture partners, the risk that a joint venture partner may become bankrupt, or may at any time have economic or business interests or goals that are inconsistent with those of the Real Estate Funds, the risk that joint venture partners may be in a position to take action contrary to its objectives, the risk of liability based upon the actions of the joint venture partner and the risk of disputes or litigation with such partners or the inability to enforce fully all rights (or the additional risk incurred in connection with enforcement of rights) one partner (or member) may have against the other, such as in connection with foreclosure on partner loans (because of risks arising under the law). In the event of any such litigation, the Real Estate Funds could be found liable to its joint venture partner for a range of damages available under applicable laws under theories arising in contract, tort or otherwise, including, depending upon applicable law, consequential damages well in excess of amounts originally at stake or exemplary or other damages for breach of contract or related claims or actions taken in good faith on the Real Estate Funds' behalf notwithstanding such risks were recommended in an effort to maximize returns for the Real Estate Funds.

**Subordinated Instruments.** A portion of the Real Estate Funds' investments may consist of securities that are subordinate in right of payment and rank junior to other securities that are secured by or represent an ownership interest in the same pool of assets, and thus, would be subordinated to the prior payment in full of such debt. As a result, such securities have a higher risk of loss.

**Lender-Liability Considerations; Equitable Subordination.** The Real Estate Funds can be accused of lender-liability which is a claim that an institutional lender or bondholder has violated a duty (whether implied or contractual) of good faith and fair dealing owed to the borrower or issuer or has assumed a degree of control over the borrower or issuer resulting in the creation of a fiduciary duty owed to the borrower or issuer or its other creditors or shareholders. Although the Real Estate Fund does not intend to engage in conduct that it expects would form the basis for a successful cause of action based upon lender liability, the potential for such a cause of action exists.

As with certain investments in the Funds, under common law principles that in some cases form the basis for lender liability claims, if a lender (i) intentionally takes an action that results in the undercapitalization of a borrower to the detriment of other creditors of such borrower, (ii) engages in other inequitable conduct to the detriment of such other creditors, (iii) engages in fraud with respect to, or makes misrepresentations to, such other creditors or (iv) uses its

influence as a stockholder to dominate or control a borrower to the detriment of other creditors of such borrower, a court may elect to use equitable subordination as a remedy. Although the Real Estate Funds do not intend to engage in conduct that would form the basis for a successful cause of action based upon the equitable subordination doctrine, the potential for such a cause of action exists.

**Environmental Liability.** Environmental compliance costs and liabilities associated with certain investments may materially impair the value of the Real Estate Funds' investments. Under various federal, state and local laws, ordinances and regulations, a current or previous owner or operator of real estate may be required to investigate and clean up certain hazardous substances released at the property, and may be held liable to a governmental entity or to third parties for property damage and for investigation and cleanup costs incurred by such parties in connection with the contamination. In addition, some environmental laws create a lien on the contaminated site in favor of the government for damages and costs it incurs in connection with the contamination. The presence of contamination or the failure to remediate contamination may adversely affect the property owner's ability to sell or lease real estate or to borrow using the real estate as collateral. The owner or operator of a site may be liable under common law to third parties for damages and injuries resulting from environmental contamination emanating from the site. Accordingly, the owners of the real estate securing the Real Estate Funds' investments could be required to pay removal or remediation costs. These costs of removal or remediation could be substantial and could negatively impact the availability of property cash flow for payments on the Real Estate Funds' investments, which may impair the value of our investments. In addition, we may invest in mortgage loans secured by real estate with environmental problems that materially impair the value of the real estate. There are substantial risks associated with such investments.

**Uninsured Losses.** The Real Estate Funds will require borrowers to maintain insurance (which may include liability, fire, extended coverage and rental loss insurance) covering each of their properties, with policy specifications and insured limits which the general partners of the Real Estate Funds believe will be adequate and appropriate under the circumstances given the relative risk of loss, the cost of such coverage and industry practice. Certain types of losses, such as acts of war, hurricanes, floods, or seismic activity, may arise which now or in the future may be uninsurable or not economically insurable. Inflation, changes in building or zoning codes and ordinances, environmental considerations, and other factors may also make it infeasible to use insurance proceeds to replace an asset if it is damaged or destroyed. If an uninsured property loss or a property loss in excess of insured limits were to occur, the Real Estate Funds' loan could be impaired.

**Changes in Laws.** Because the Real Estate Funds' borrowers may not be able to pass along to buyers or tenants any increases in local sales, income, asset, service or transfer taxes, such increases may adversely affect the value of real property collateral securing the Real Estate Funds' investments. The Properties securing the Real Estate Funds' loans will also be subject to various local regulatory requirements and to fire and life-safety requirements, which may be changed from time to time in a way that increases the property owner's cost of development or ownership. Compliance, or failure to comply, with such additional requirements may impair the value of property securing the Real Estate Funds' loans.

For a further discussion of these and related items, see **Item 4** (Advisory Business), **Item 10** (Other Financial Industry Activities and Affiliations), **Item 11** (Code of Ethics, Participation or Interest in Client Transactions and Personal Trading) and **Item 12** (Brokerage Practices).

**ITEM 9. DISCIPLINARY INFORMATION**

There are no legal or disciplinary events that are material to the Adviser's advisory business or the integrity of its management.

## **ITEM 10. OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

Knighthead is the investment manager for the Knighthead Master Feeder Funds and investment adviser for Knighthead NY Fund and the Managed Account Clients. Knighthead Insurance is the investment adviser for Knighthead Annuity and Knighthead Holdings. Knighthead provides investment advice for the BSOF Funds and CPPIB with respect to each Approved Investment. Knighthead SMA provides investment advice for BIOV1 Segregated Portfolio with respect to each Approved Investment.

Knighthead or its Principals, either directly or indirectly, control, the following Relying Advisers:

- Knighthead Capital Management SMA, LLC
- Knighthead Realty Capital Management, LLC
- Knighthead Insurance Capital Management, LP

Principals and employees of the Adviser are subject to Knighthead's Code of Ethics. No management persons are registered, or have an application pending to register, as a broker-dealer or a registered representative of a broker-dealer.

No management persons are registered, or have an application pending to register, as a futures commission merchant, commodity pool operator, commodity trading adviser, or an associated person of the foregoing entities.

### **Potential Conflicts of Interest**

The Adviser (and its principals, affiliates and employees) serves as investment manager for multiple clients, including the Knighthead Funds and the Subadvised Funds (to the extent of the Approved Investments), and may serve as investment manager or investment adviser to other client accounts and conduct investment activities for its own accounts. Such other entities or accounts may also have investment objectives or may implement investment strategies similar to those of a Client.

The Adviser (or its principals, affiliates or employees) may give advice or take action with respect to a Client that differs from the advice given with respect to a different Client. For example, while the Domestic Fund has an investment objective and strategy that is substantially similar to that of the Offshore Fund, it is likely that due to the timing of contributions and withdrawals and due to tax, regulatory or other considerations, the portfolio of the Domestic Fund will be different (sometimes significantly) from the portfolio of the Offshore Fund. Indeed, there may be times when the Domestic Fund acquires an investment and subsequently (after regulatory, tax or other considerations are satisfied or otherwise) sells, assigns or transfers all or a portion of such investment to the Offshore Fund or the Master Fund. As a result of such portfolio differences, the return on investment in the Domestic Fund may differ from that of the Offshore Fund. To the extent a particular investment is suitable for multiple Clients; such investments will be allocated among such Clients pro rata based on assets under management or

in some other manner which the Adviser determines is fair and equitable under the circumstances to all such Clients. Simultaneous identical portfolio transactions for multiple Clients may tend to decrease the prices received, and increase the prices required to be paid, by any given Client for its portfolio sales and purchases. Where less than the maximum desired amount of a particular investment is available at a favorable price, the investment will be allocated among the applicable Clients in an equitable manner as determined by the Adviser.

In addition, in limited circumstances, Knighthead is permitted to effect purchase and sale transactions (including swaps) between the Funds subject to the following guidelines: (i) such transactions shall be effected for cash consideration at the current market price of the particular securities, and (ii) no commissions or other remuneration shall be paid to Knighthead in connection with any such transaction. Knighthead must consult with the Chief Compliance Officer prior to affecting any cross transactions.

Certain clients of the Adviser engage in direct lending, and to the extent investments are suitable for multiple Clients, such investments will be allocated among such Clients generally *pro rata* based on assets under management or in some other manner which the Adviser determines to be fair and equitable under the circumstances to all such Clients.

The Adviser may, under certain limited circumstances, recommend a security in which the Adviser, directly or indirectly, has an interest. For instance, one or more of the Clients may invest capital in another of the Clients managed by the Adviser. In addition, the general partners of certain of the Clients and employees of the Investment Manager have invested their own capital in certain Clients. This may represent a conflict of interest for the Adviser. The Adviser will not receive any compensation for selling interests in the Clients, the Adviser will receive compensation in its capacity as manager of these funds based in part upon the amount invested in the funds.

While a Client's portfolio is typically based on pricing from independent sources such as third-party pricing services, the Administrator is also entitled to rely on information provided by the Adviser. Because the Adviser or its affiliates are allocated a percentage of net profits (which includes unrealized gains), the Adviser's involvement regarding valuation of portfolios may present a potential conflict of interest.

As a result of the foregoing, the Adviser (and its principals, affiliates and employees) may have conflicts of interest in allocating their time and activity between Clients, in allocating investments among the Clients and in effecting transactions for Clients, including ones in which the Adviser, its affiliates and their principals may have a greater financial interest.

The Adviser will use its best efforts in connection with the purposes and objectives of a Client and will devote so much of its time and efforts to the affairs of such Client as may, in its judgment, be necessary to accomplish the purposes of such Client. The Adviser and its principals, affiliates or employees may conduct any other business including any business within the securities industry. Without limiting the generality of the foregoing, the Adviser and its principals, affiliates or employees may act as investment manager or investment adviser for others, may manage funds or capital for others, may have, make and maintain investments in its own name or through other entities and may serve as an officer, director, consultant, partner or

stockholder of one or more investment funds, partnerships, securities firms or advisory firms. It may not always be possible or consistent with the investment objectives of the various persons or entities described above and of the Clients for the same investment positions to be taken or liquidated at the same time or at the same price.

Ara Cohen and Thomas Wagner are principals of the Adviser, and may have a conflict of interest with regard to their fiduciary duties to the Clients and to the Adviser. However, each principal is, at all times, obligated to act in the best interest of the clients and the principals will ensure that potential conflicts of interest are resolved fairly and in the interests of the Clients.

Please see **Item 8** (Methods of Analysis, Investment Strategies and Risk of Loss) and **Item 11** (Code of Ethics, Participation or Interest in Client Transactions and Personal Trading).

## **ITEM 11. CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING**

### **Code of Ethics**

The Adviser has adopted a code of ethics pursuant to Advisers Act Rule 204A-1. The Adviser's code of ethics requires full compliance with all applicable laws and regulations governing the provision of investment management services to the Clients. In addition, the code of ethics highlights the fiduciary duty that the Adviser has to Clients, including the affirmative duty to act in the best interests of Clients and to make full and fair disclosure of material facts. The Adviser expects each supervised person to act with integrity, competence and dignity and in an ethical manner when dealing with the public, clients, investors and prospective investors in the funds, service providers and fellow supervised persons. The Adviser also expects supervised persons to adhere to the highest standards with respect to any potential conflict of interest with the Clients.

The Adviser's code of ethics contains guidelines relating to personal trading by supervised persons (and certain of their immediate family members). The Adviser's supervised persons are generally not permitted to purchase or sell securities without the advance written approval of the Chief Compliance Officer or her designee, provided that supervised persons may invest in (i) direct obligations of the Government of the United States; (ii) bankers' acceptances, bank certificates of deposit, commercial paper and high quality short-term debt instruments, including repurchase agreements; (iii) shares issued by money market funds; (iv) shares issued by registered open-end investment companies (other than that are affiliated with the Adviser); and/or (v) shares issued by unit investment trusts that are invested exclusively in one or more registered open-end investment companies without obtaining such permission. The Adviser's code of ethics also requires supervised persons to provide it with certain securities holdings and periodic transaction reports, as required by Advisers Act Rule 204A-1.

Subject to the limited circumstances described below, the Adviser and its related persons do not generally recommend to the Clients or generally buy or sell for the Clients securities in which the Adviser or its related persons have a material financial interest. However, pursuant to agreements between Knighthead and the Subadvised Funds, Knighthead and its related persons may be required to co-invest in certain Approved Investments in which Clients have a non-material interest. Although the Adviser's principals, employees and officers may buy and sell securities for their own account (which may require the prior written approval of the Chief Compliance Officer or her designee) or the account of others, they may not buy securities from or sell securities to Clients.

The Adviser's code of ethics has specific provisions relating to identifying potential conflicts of interest. The provisions prohibit a supervised person from directing Client transactions for the purpose of obtaining a personal benefit. They also generally prohibit personal business dealings with Clients or investors without the prior approval of the Chief Compliance Officer or her designee. The code of ethics also includes provisions relating to accepting offers of gifts or entertainment from third parties.

Supervised persons are required to conduct all personal securities transactions in full compliance with the code of ethics, and should not take any action in connection with personal securities transactions that could cause even the appearance of unfairness or impropriety, relative to the Clients. Ambiguous situations should be promptly brought to the attention of the Chief Compliance Officer or her designee, and should be resolved in favor of Client interests.

All violations of the code of ethics must be promptly reported to the Chief Compliance Officer or her designee, who is primarily responsible for administering and enforcing the code of ethics. A violation of the code of ethics may result in the imposition of disciplinary and remedial measures, including, without limitation, disgorgement or termination.

Clients may obtain, free of charge, a full copy of the Adviser's code of ethics by contacting it at the following address:

Knighthood Capital Management, LLC  
1140 Avenue of the Americas, 12th Floor  
New York, NY 10036  
Attention: Chief Compliance Officer  
Telephone: (212) 356-2900  
Facsimile: (212) 356-2901  
Email: info@knighthood.com

For a further discussion of these and related items, see **Item 8** (Methods of Analysis, Investment Strategies and Risk of Loss), **Item 10** (Other Financial Industry Activities and Affiliations) and **Item 12** (Brokerage Practices).

### **Participation or Interest in Client Transactions**

The Adviser may, under certain limited circumstances, recommend a security in which the Adviser, directly or indirectly, has an interest. For instance, one or more of the Clients may invest capital in another of the Clients managed by the Adviser. In addition, the general partners of certain of the Clients and employees of the Investment Manager have invested their own capital in certain Clients. This may represent a conflict of interest for the Adviser. The Adviser will not receive any compensation for selling interests in the Clients, the Adviser will receive compensation in its capacity as manager of these funds based in part upon the amount invested in the funds.

## ITEM 12. BROKERAGE PRACTICES

### General

Knighthead is authorized to determine the broker or dealer to be used for each securities transaction for its Funds and, to the extent of the Approved Investments, the Subadvised Funds. Each Fund maintains accounts at its Prime Brokers and each Subadvised Fund maintains accounts at its own prime broker, through which the Funds and Subadvised Funds settle trades, borrow securities and maintain custody of its securities. Knighthead also maintains a list of approved brokers which may execute trades on behalf of Knighthead and its Funds and, to the extent of the Approved Investments, the Subadvised Funds. Consent of Knighthead's Chief Compliance Officer or her designee is required prior to the use of any brokers not on the approved list. Currently, the Adviser does not believe Item 12 is applicable to Knighthead Realty or the Real Estate Funds, however, if this changes in the future, the Adviser will amend its brochure to reflect such change.

In selecting a broker for each specific portfolio transaction, Knighthead will use its best judgment to choose the broker-dealers most capable of providing "best execution" on an overall basis. As a matter of policy, broker-dealers will not be selected by Knighthead solely on the basis of price, but will be selected on the basis of an evaluation by Knighthead of the overall value and quality of the brokerage services provided by such firms. Therefore, consideration of all relevant factors, including certain intangibles, ranging from "soft dollars" to a broker's customer service is essential in considering and evaluating best execution. Applicability of specific criteria will vary depending upon the nature of the transaction, the market in which it is effected, and the extent to which it is possible to select from among multiple brokers or dealers capable of effecting the transaction.

In reviewing the selection or use of brokers, Knighthead will consider any potential conflicts of interest, such as the occurrence of referrals or other business dealings between the broker-dealer and Knighthead or its principals.

### Soft Dollars

In selecting brokers or dealers to execute transactions, Knighthead need not solicit competitive bids and does not have an obligation to seek the lowest available commissions, mark-ups or other compensation (collectively, "**Commissions**"). It is not Knighthead's practice to negotiate "execution only" Commissions, thus the Funds and/or Subadvised Funds may be deemed to be paying for research, brokerage or other services provided by the broker which are included in the Commissions.

Section 28(e) of the Exchange Act is a "safe harbor" that permits an investment manager to use commissions or "soft dollars" to obtain research and brokerage services that provide lawful and appropriate assistance in the investment decision-making process. Knighthead will limit the use of "soft dollars" to obtain research and brokerage services to services which constitute research and brokerage within the meaning of Section 28(e). Research services within Section 28(e) may include, but are not limited to, research reports (including market research); certain financial newsletters and trade journals; software providing analysis of securities

portfolios; corporate governance research and rating services; attendance at certain seminars and conferences; discussions with research analysts; meetings with corporate executives; consultants' advice on portfolio strategy; data services (including services providing market data, company financial data and economic data); advice from brokers on order execution; and certain proxy services. Brokerage services within Section 28(e) may include, but are not limited to, services related to the execution, clearing and settlement of securities transactions and functions incidental thereto (i.e., connectivity services between an investment manager and a broker-dealer and other relevant parties such as custodians); trading software operated by a broker-dealer to route orders; software that provides trade analytics and trading strategies; software used to transmit orders; clearance and settlement in connection with a trade; electronic communication of allocation instructions; routing settlement instructions; post trade matching of trade information; and services required by the SEC or a self-regulatory organization such as comparison services, electronic confirms or trade affirmations.

In some instances, Knighthead may receive a product or service that may be used only partially for functions within Section 28(e) (e.g. an order management system, trade analytical software or proxy services). In such instances, Knighthead will make a good faith effort to determine the relative proportion of the product or service used to assist Knighthead in carrying out its investment decision-making responsibilities and the relative proportion used for administrative or other purposes outside Section 28(e). The proportion of the product or service attributable to assisting Knighthead in carrying out its investment decision-making responsibilities will be paid through Commissions generated by Fund and/or Subadvised Fund transactions and the proportion attributable to administrative or other purposes outside Section 28(e) will be paid for by Knighthead from its own resources.

Research and brokerage services obtained by the use of Commissions arising from a Fund and/or Subadvised Fund's portfolio transactions may be used by Knighthead in its other investment activities and thus, such Fund and/or Subadvised Fund may not necessarily, in any particular instance, be the direct or indirect beneficiary of the research or brokerage services provided.

Although Knighthead will make a good faith determination that the amount of Commissions paid is reasonable in light of the products or services provided by a broker, Commissions are generally negotiable and thus, selecting brokers on the basis of considerations that are not limited to the applicable commission rates may result in higher transaction costs than would otherwise be obtainable. The receipt of such products or services and the determination of the appropriate allocation in the case of "mixed use" products or services creates a potential conflict of interest between Knighthead and its Funds and/or Subadvised Funds.

In selecting brokers and negotiating Commissions, Knighthead will take into account the financial stability and reputation of brokerage firms, and the research, brokerage or other services provided by such brokers. Knighthead may place transactions with a broker or dealer that (i) provides Knighthead (or an affiliate) with the opportunity to participate in capital introduction events sponsored by the broker-dealer or (ii) refers investors to a Knighthead Master Feeder Fund or other products (including, without limitation, managed accounts) advised by Knighthead (or an affiliate), provided that Knighthead is not selecting the broker-dealer in

recognition of the opportunity to participate in such capital introduction events or the referral of investors and so long as otherwise consistent with seeking best execution.

Any use of soft dollars requires approval of the Chief Compliance Officer or her designee.

The use of soft dollars could create a conflict of interest between Knighthead and its Funds and/or Subadvised Funds, because the Funds and/or Subadvised Funds pay for such products and services that are not exclusively for their benefit and might otherwise be payable by Knighthead.

Since Knighthead may select brokers that provide research or other services that it might otherwise have to pay for itself, this may give Knighthead an incentive to select or recommend a broker-dealer based on its interest in receiving the research or other products or services, rather than on a Fund or Subadvised Fund's interest in receiving the most favorable execution.

Any products and services provided by brokers will be used to service the accounts of all Funds and/or Subadvised Funds. Knighthead will not seek to allocate soft dollar benefits to the accounts of the Funds and/or Subadvised Funds proportionately to the soft dollar credits that such accounts generate.

Knighthead does not recommend, request or require that a Fund and/or Subadvised Fund execute transactions through a specified broker-dealer, and Knighthead does not permit the Funds and/or Subadvised Funds to direct brokerage.

### **Trade Error Policies and Procedures**

Knighthead will only be responsible for losses due to trade errors caused by the fraud, bad faith, willful misconduct or gross negligence of Knighthead. When an error is made in the account of a Fund and/or Subadvised Fund, Knighthead will use its best efforts to correct the trade immediately. Knighthead is not responsible for the errors of other persons, including third-party brokers and custodians. Knighthead shall seek to correct trade errors attributable to a third-party, including the executing broker-dealer, in such third-party's error account, if applicable. Knighthead shall not absorb or otherwise be responsible for losses resulting from such errors.

### **Aggregation of Transactions**

When appropriate, Knighthead may, but is not required to, aggregate Client orders to achieve more efficient execution or to provide for equitable treatment among accounts. Clients participating in aggregated trades will be allocated securities based on the average price achieved for such trades.

For a further discussion of these and related items, see **Item 8** (Methods of Analysis, Investment Strategies and Risk of Loss), **Item 10** (Other Financial Industry Activities and Affiliations) and **Item 11** (Code of Ethics, Participation or Interest in Client Transactions and Personal Trading).

### **ITEM 13. REVIEW OF ACCOUNTS**

The Adviser performs various daily, weekly, and monthly reviews of its Clients' balances, transactions and positions. The administrator for the Funds prepares reconciliation reports and complete month-end close packages. The Adviser's operations team is primarily responsible for reviewing the accounts of the Funds and reviews the accounts of the Subadvised Funds although the Adviser is not primarily responsible for such review. As part of the Adviser's review of the Funds' accounts, it reviews and signs off on the administrator's independent net asset value calculation prior to the administrator's release of the net asset value statements to investors in the Funds. In addition, Knighthead's valuation committee formally meets to approve the month-end valuations for each of the positions held by the Funds as well as the Subadvised Funds, provided, however (i) the ultimate responsibility falls to the Subadvised Funds and the Managed Account Clients for the valuation of their respective positions; and (ii) with respect to certain positions held by the Managed Account Clients, valuation may be done less than monthly.

Knighthead Realty meets periodically to discuss valuation for the Real Estate Funds as well as the Managed Account Clients with respect to certain investments. For the Real Estate Funds, Knighthead Realty reviews the administrator's reconciliations and approves the data for the quarterly unaudited statements to investors in the Real Estate Funds.

#### **ITEM 14. CLIENT REFERRALS AND OTHER COMPENSATION**

For a discussion of these and related items, see **Item 10** (Other Financial Industry Activities and Affiliations) and **Item 12** (Brokerage Practices).

## **ITEM 15. CUSTODY**

While it is the Adviser's practice not to accept or maintain physical possession of any of the KH Funds' assets (the KH Funds' assets are in the custody of its custodian, Prime Brokers and banks), the Adviser is deemed to have custody of their assets under Rule 206(4)-2 of the Investment Advisers Act of 1940, as amended, because the Adviser has the authority to access funds and deduct fees and expenses from the KH Funds' accounts.

The Adviser currently maintains the assets of the KH Funds in accounts with a "qualified custodian" pursuant to Rule 206(4)-2 under the Advisers Act. While Rule 206(4)-2 generally requires an investment adviser to ensure that a qualified custodian sends account statements to all of its Clients whose funds the custodian holds at least quarterly, the Adviser is not subject to such requirement because the KH Funds are subject to an audit at least annually by an independent auditor that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board. The Adviser generally distributes audited financial statements to all investors in the KH Funds within 120 days of the applicable fiscal year-end.

An affiliate of the Adviser maintains custody of assets of certain Clients of the Adviser. Accordingly, the Adviser engaged an independent public accountant to conduct an annual surprise examination of the affiliate and such assets.

The Adviser does not custody the assets of the Managed Account Clients or the Subadvised Funds.

## **ITEM 16. INVESTMENT DISCRETION**

Knighthead and its affiliates have discretionary authority with respect to the investment decisions on behalf of the Knighthead Master Feeder Funds and Knighthead NY Fund pursuant to their respective investment advisory agreements or otherwise through the formation documents of the Knighthead Master Feeder Funds and Knighthead NY Fund, as applicable.

Knighthead has discretionary authority with respect to the investment decisions on behalf of the Managed Account Clients pursuant to their respective investment management agreements. Knighthead appointed Knighthead Realty as subadvisor to the Managed Account Clients for certain investments pursuant to their respective investment management agreements. Knighthead also appointed a third-party manager as subadvisor to the Managed Account Clients for certain investments pursuant to their respective investment management agreements.

Knighthead Insurance has discretionary authority with respect to the investment decisions on behalf of Knighthead Annuity and Knighthead Holdings pursuant to the JV Agreement. Knighthead Insurance has appointed Knighthead as subadvisor to Knighthead Annuity and Knighthead Holdings.

Investment decisions for Funds are made in accordance with such Funds' investment objectives and guidelines, which may include limitations on the discretion of Knighthead to invest in certain securities or categories of securities.

Knighthead Realty has discretionary authority with respect to the investment decisions on behalf of the Real Estate Funds pursuant to the investment management agreement with the Real Estate Funds. Knighthead and Knighthead SMA have discretionary investment and trading authority on behalf of the Subadvised Funds with respect to each Approved Investment, but a third-party manager maintains discretionary authority for the Subadvised Funds generally and retains the right to approve or reject each co-investment opportunity.

For a further discussion of these and related items, see **Item 4** (Advisory Business) and **Item 10** (Other Financial Industry Activities and Affiliations).

## **ITEM 17. VOTING CLIENT SECURITIES**

The Adviser has been delegated the authority and right to vote proxies and elect on corporate actions received by the Knighthead Funds. In addition, Knighthead has been granted authority to vote proxies received by the Subadvised Funds with respect to the Approved Investments. The Adviser has policies and procedures in place for the voting of proxies and processing of corporate actions on behalf of each Client. The Adviser determines how to vote after studying the proxy materials and any other materials that may be necessary or beneficial to voting. The Adviser votes in a manner that it believes reasonably furthers the best interests of such Client and is consistent with its investment philosophy, which may result in different voting results for proxies for the same issuer.

Generally, the Adviser will vote in favor of routine corporate housekeeping proposals, including election of directors (where no corporate governance issues are implicated), selection of auditors, and increases in or reclassification of common stock. Generally, the Adviser will vote against proposals that make it more difficult to replace members of the issuer's board of directors, including proposals to stagger the board, cause management to be overrepresented on the board, introduce cumulative voting, introduce unequal voting rights, and create supermajority voting.

For other proposals, the Adviser will determine whether a proposal is in the best interests of its Clients and may take into account the following factors, among others: whether the proposal was recommended by management and the Adviser's opinion of management, whether the proposal acts to entrench existing management, and whether the proposal fairly compensates management for past and future performance.

If a proxy vote creates a material conflict between the Adviser's interests and the interests of the Clients, the Adviser will resolve the conflict before voting the proxies. The Adviser will either disclose the conflict to the Clients or take other steps designed to ensure that a decision to vote the proxy was based on the Adviser's determination of the Client's best interest and was not the product of the conflict.

Clients cannot generally direct how the Adviser votes in a particular situation.

From time to time, securities held in the accounts of Clients may be the subject of class action lawsuits. The Adviser has no obligation to determine if securities held by the Client are subject to a pending or resolved class action lawsuit.

If the Adviser receives written or electronic notice of a class action lawsuit, settlement, or verdict affecting securities owned by a Client, and no material conflicts exist, the Chief Compliance Officer or her appointee will be responsible for completing the proof of claim forms and other materials in a timely and appropriate manner.

Clients may obtain, free of charge, a full copy of the Adviser's proxy voting policies and procedures and/or a record of proxy votes by contacting it at the following address:

Knighthead Capital Management, LLC  
1140 Avenue of the Americas, 12th Floor  
New York, NY 10036  
Attention: Chief Compliance Officer  
Telephone: (212) 356-2900  
Facsimile: (212) 356-2901  
Email: [info@knighthead.com](mailto:info@knighthead.com)

**ITEM 18. FINANCIAL INFORMATION**

The Adviser does not require or solicit prepayment of fees six months or more in advance.

The Adviser is not aware of any financial condition that is reasonably likely to impair its ability to meet contractual commitments to the Clients.

The Adviser has not been the subject of a bankruptcy petition at any time during the past ten years.

**ITEM 19.     REQUIREMENTS FOR STATE-REGISTERED ADVISERS**

The Adviser is not registered with any State as an investment adviser.